# CASES DECIDED
IN
# THE UNITED STATES COURT OF CLAIMS

MAY 1, 1975 TO PART OF OCTOBER, 1975

WITH

## REPORT OF
## DECISIONS OF THE SUPREME COURT IN COURT OF CLAIMS CASES

REPORTED BY
AUDREY BERNHARDT
REPORTER

## VOLUME 207

U.S. GOVERNMENT PRINTING OFFICE
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Chief Judge
Wilson Cowen

Judges
Oscar H. Davis
Byron Skelton
Philip Nichols, Jr.
Shiro Kashiwa
Robert L. Kunzig
Marion T. Bennett

Senior Judges
Marvin Jones
James R. Durfee
Don N. Laramore

Chief, Trial Division
Roald A. Hogenson

Trial Judges
C. Murray Bernhardt
Mastin G. White[1]
Lloyd Fletcher
George Willi
Louis Spector
David Schwartz
Harry E. Wood
Joseph V. Colaianni
Kenneth R. Harkins
Philip R. Miller
Hal D. Cooper[2]
Thomas J. Lydon
Charlotte P. Murphy
John P. Wiese

Reporter
Audrey Bernhardt

Secretary
Dudley G. Skinker

Clerk
Frank T. Peartree

Chief Deputy Clerk
David J. Clouser

Financial Officer
Robert F. Wirtz

Auditors
Lee E. Sauer
Thomas F. Howard

Librarian
Lou Ella L. Ingram

Bailiff-Marshal
Charles A. Link, Jr.

---

[1] Retired, effective January 1, 1971, and recalled as a senior trial judge.

[2] Resigned effective October 17, 1975 to enter private practice of law.

# ASSISTANT ATTORNEYS GENERAL

(Charged with the defense of the Government)

MAY 1, 1975–OCTOBER 31, 1975

| | |
|---|---|
| WALLACE H. JOHNSON<br>Land and Natural Resources Division | SCOTT P. CRAMPTON<br>Tax Division |

IRVING JAFFE
(Acting Assistant Attorney General)
May 1–18, 1975

REX E. LEE
May 19, 1975–October 31, 1975
Civil Division

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[Submitted by Chief Commissioner to Congress pursuant to Public Law 89-681, 80 Stat. 958]

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[Submitted by Chief Commissioner to Congress pursuant to Alaska Native Claims Settlement Act, Pub. L. 92-203, 85 Stat. 688]

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No. 8526; Abell

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# DESIGNATION OF JUDGES OF THE UNITED STATES COURT OF CLAIMS FOR SERVICE IN OTHER CIRCUITS

The Chief Justice of the United States, the Honorable Warren E. Burger, pursuant to the authority vested in him by Title 28, United States Code, individually designated and assigned the following judges of the United States Court of Claims to perform judicial duties of a circuit judge for the periods and in the circuits listed below:

| Judge | United States Court of Appeals | Period* |
|---|---|---|
| Judge Byron Skelton | Fifth Circuit | May 12–15, 1975 |
| Judge Oscar H. Davis | Second Circuit | June 23–27, 1975 |
| Judge Robert L. Kunzig | Seventh Circuit | Sept. 22–26, 1975 |

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*and for such additional time as may be required to complete unfinished business.

## NOTICE OF AMENDMENTS TO THE RULES OF THE UNITED STATES COURT OF CLAIMS

Effective July 1, 1975, the Rules of the United States Court of Claims were amended pursuant to General Order No. 1 of 1975.

Copies of the amendments to the Rules are available upon request at the Office of the Clerk, United States Court of Claims, 717 Madison Place, N.W., Washington, D.C. 20005.

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## ORAL ARGUMENT BEFORE COURT OF CLAIMS VIA TELEVISION

On October 16, 1975, the United States Court of Claims made history when a panel of the court consisting of Judges Byron Skelton, Philip Nichols, Jr. and Robert L. Kunzig, sitting in Washington, D.C., utilized for the first time a long-distance television system to hear oral arguments in a contract dispute pending before the court. Counsel for plaintiff and the Government presented their arguments from New York City. A review of the demonstration with an accompanying picture is reported in the AMERICAN BAR ASSOCIATION JOURNAL, Vol. 61, December 1975, page 1533.

# CASES DECIDED

# IN

# THE UNITED STATES COURT OF CLAIMS

**May 1, 1975 to part of October 1975, and other cases not heretofore published.**

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## GEORGE M. BOYD v. THE UNITED STATES

[No. 53-74. Decided May 14, 1975]

ON DEFENDANT'S MOTIONS TO DISMISS AND FOR SUMMARY JUDGMENT AND PLAINTIFF'S CROSS-MOTION FOR SUMMARY JUDGMENT

**Military pay; mandatory retirement; nonselection for promotion; administrative discretion.**—Plaintiff, a retired regular Air Force major with long and honorable active duty, was twice deferred for promotion to permanent lieutenant colonel, and was mandatorily retired pursuant to 10 U.S.C. § 8913. Plaintiff unsuccessfully sought to have his latest Officer Effectiveness Report (OER) voided, and thereafter the Air Force Board for Correction of Military Records resolved in plaintiff's favor reasonable doubt that plaintiff had been justly treated by the last selection board, recommended that his final OER be voided and that he be returned to active duty and promoted to permanent lieutenant colonel, and rejected his request for promotion to the temporary grade of colonel. The Assistant Secretary of the Air Force for Manpower and Reserve Affairs rejected the board's recommendations and denied plaintiff the relief requested because the Secretary found no error or injustice in the record. Plaintiff challenges this action on the basis of the final 7-2 OER rating set out in detail in the opinion. The OER included glowing letters of evaluation from plaintiff's supervisors at McConnell AFB. The statement of the rating officer (who had not supervised plaintiff during the period covered by the OER) indicated that under plaintiff's leadership his detachment had functioned in an excellent manner. Plaintiff contends that the 7-2 rating is inconsistent with the rater's comments and with the letters of evaluation. The Assistant Secretary found no inconsistencies and further stated that any inconsistency between the OER and the evaluation letters would not in any event provide a basis for voiding the OER. After a discussion of the discretionary authority of the Secretary under 10 U.S.C. § 1552 and implementing regulations and of this court's scope of review of an administrative decision, it is *held* that the correction board's conclusion in plaintiff's favor, based entirely on what it described as "reasonable doubt" that plaintiff had been justly treated by the selection board, does not withstand the contrary analysis and conclusions made in good faith, within the law, and without arbitrariness or caprice by the Assistant Secretary, no disparity having been shown between the rater's laudatory comments and the 7-2 rating; and that there is no legal basis for any of plaintiff's claims. Defendant's motions to dismiss and for summary judgment are granted, plaintiff's cross-motion for summary judgment is denied and the petition is dismissed.

**Court of Claims jurisdiction; parties; claim against United States.**

[1] Where a petition filed in the court names as defendants the United States and other individuals in their official capacity, the latter are not proper defendants since the court's jurisdiction is limited to rendition of judgments only against the United States.

**Courts ⚿ 462**

**Military pay; correction of military records; discretion of Secretary of Service; civilian officers or employees, boards of; remove an injustice.**

[2] Pursuant to 10 U.S.C. § 1552, the Secretary of the Service concerned under procedures established by him and acting through boards of civilians of the executive part of the particular military department, may correct a military record when he considers it necessary to correct or remove an injustice. The decision of the Secretary is a discretionary one.

**Armed Services ⚿ 4**

**Military pay; correction of military records; discretion of Secretary of Service; Air Force.**

[3] Whereas the Secretary of the Air Force in correcting a military record acts through a board of civilians pursuant to 10 U.S.C. § 1552, under AFR 31-3, para. 22 (1970) he retains the authority to take such final action on board recommendations as he determines to be appropriate. Furthermore, under 10 U.S.C. § 8012(e) the Secretary of the Air Force, as he considers appropriate, may assign, detail and prescribe the duties of the members of the Air Force and civilian personnel of that Department; this provision encompasses the board of civilians constituting the Air Force Board for the Correction of Military Records.

**Armed Services ⚿ 4, 27**

**Military pay; courts and boards; Boards for Correction of Military Records; decision of board, finality of.**

[4] Although, because of the broad authority of the Boards for Correction of Military Records, their recommendations are entitled to considerable respect, the Secretary of the Military Service concerned

may overrule such recommendations where the particular board's findings are not justified by the record on which the findings were made.

Armed Services 🔑 4

**Military pay; Court of Claims jurisdiction; administrative or executive decision; review of by court.**

[5] The Court of Claims may reject the decision of a Secretary of the Service on an appeal for correction of military records only if he has exercised his discretion arbitrarily, capriciously, in bad faith, contrary to substantial evidence, or where he has gone outside the board record, or fails to explain his actions, or violates applicable law or regulations. Short of such decisional errors, the discretion of the Secretary or his duly appointed delegate is not to be interfered with lightly, especially in view of the courts' traditional reluctance to involve themselves in internal affairs of the military, in which they have little or no special competence and less responsibility.

Armed Services 🔑 8

**Military pay; presumptions; official actions, regularity of.**

[6] The Secretary and selection boards appointed pursuant to his authority, 10 U.S.C. § 8297, are presumed to perform fairly and lawfully in absence of clear and persuasive evidence to the contrary.

Courts 🔑 464(1)

**Military pay; promotions; recommendations of local commanding officers.**

[7] For purposes of officer promotions Air Force policy forbids letters of evaluation by local commanders from being binding on the rating officer who must make his determination on a broad basis taking into consideration other factors. The local commanders may not usurp the assigned function of the rater since this would pervert the Officer Effectiveness Report system.

Armed Services 🔑 7

**Military pay; promotions; rating officer.**

[8] Under Air Force Manual 36-10, para. 6-5 (1967), the rating officer is charged with making such judgment as to an officer's effectiveness only in comparison with other officers serving in the same grade at the time the report is made. There is no discrepancy between a rater's recommendation that an officer be promoted along with his contemporaries and a letter of evaluation by a local commander recommending promotion "at the earliest date or "immediate promotion" where immediate promotion would be promotion with contemporaries and where selection for promotion takes into account the allocated number of officers authorized for promotion and determination of those within the limited number best qualified.

Armed Services 🔑 7

**Military pay; promotions; administrative discretion.**

[9] The function of the Secretary of the Service concerned and a selection board as to appointments and promotions is discretionary and their actions cannot be presumed.

Armed Services ⚷ 7

**Military pay; promotions; courts, jurisdiction.**

[10] Ratings and promotions in the military service are discretionary matters with which the court will continue to be scrupulous not to intervene unless clear error is shown or relief is mandated by law or regulation.

Armed Services ⚷ 7

*G. Edmond Hayes*, attorney of record, for plaintiff.

*Lawrence S. Smith*, with whom was *Assistant Attorney General Carla A. Hills*, for defendant.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

The question presented in this case is whether the Assistant Secretary of the Air Force for Manpower and Reserve Affairs acted arbitrarily and capriciously, and thus unlawfully, in rejecting certain recommendations of the Air Force Board for Correction of Military Records (hereinafter, the Correction Board) which were favorable to plaintiff and would have resulted in his promotion. We hold that the Assistant Secretary did not act arbitrarily, capriciously, or contrary to law. Therefore, his action cannot be set aside by the court. Plaintiff's petition must be dismissed.[1]

Plaintiff is a retired Regular major in the United States Air Force with long and honorable active duty, beginning as a Reserve officer in 1948. Having been twice deferred for promotion to permanent lieutenant colonel, he was mandatorily retired on November 1, 1971, pursuant to 10 U.S.C.

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[1] Plaintiff's petition named the Secretary of Defense and the Secretary of the Air Force as defendants, in addition to the United States. As plaintiff conceded in oral argument, those named individuals are not proper defendants in this action. Plaintiff's petition is therefore dismissed as to those individuals at the outset. This court can enter judgments only against the United States. 28 U.S.C. § 1491; *National Cored Forgings Co. v. United States*, 126 Ct. Cl. 250, 256, 115 F. Supp. 469, 473 (1953).

§ 8913. The second selection board which, on March 1, 1971, considered, but did not select plaintiff for promotion, had before it as part of plaintiff's official record, his latest Officer Effectiveness Report (OER) covering the period November 15, 1969 through November 14, 1970. Upon notification that he was to be mandatorily retired, plaintiff unsuccessfully sought, under the provision of AFR 31–11, to have the foregoing OER voided by the Officer Personnel Records Review Board. Then, on July 31, 1971, he applied to the Correction Board for the following relief: (1) voidance of his most recent OER; (2) promotion to permanent lieutenant colonel effective July 9, 1971; (3) further promotion to the temporary grade of colonel; and (4) revocation of his mandatory retirement and restoration to active duty. The board held a hearing at which plaintiff made a personal appearance and was represented by counsel. For reasons discussed below, the Correction Board, in a decision on December 17, 1971, resolved in plaintiff's favor "reasonable doubt" that plaintiff had been justly treated by the selection board of March 1, 1971. It recommended that plaintiff's OER be voided, that plaintiff be restored to active duty, and that he be promoted to the rank of permanent lieutenant colonel. Only plaintiff's requested further promotion to the temporary grade of colonel was rejected by the board.

The board's recommendations were reviewed by the Assistant Secretary of the Air Force for Manpower and Reserve Affairs.[2] The Assistant Secretary, on February 21, 1972, rejected the board's recommendations and denied plaintiff's application because he found no error or injustice in the record. Plaintiff challenges the Assistant Secretary's action by this suit filed February 13, 1974.

The alleged error or injustice in this case is the rating received by plaintiff in that final OER. The OER required the rater to assess the officer's "overall evaluation" and "promotion potential." In the former category there were nine choices, the highest three of which were in the following order of descent:

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[2] Pursuant to 10 U.S.C. § 1552, the Secretary was authorized, under procedures established by him, to act upon the recommendations of the Correction Board. The Secretary delegated this function to the Assistant Secretary by AF Order 100.1 of August 1, 1969, and by a later order dated April 17, 1972.

9 Absolutely superior.
8 Outstanding; almost never equaled.
7 Excellent; seldom equaled.

In the category of "promotion potential," there were four choices, the highest three of which were:

4 Outstanding growth potential based on demonstrated performance; promote well ahead of contemporaries.
3 Demonstrates capability for increased responsibility; consider for advancement ahead of contemporaries.
2 Performing well in present grade; should be considered for promotion along with contemporaries.

Plaintiff was rated a 7–2.

The questioned OER contained two attached "letters of evaluation." The letter by plaintiff's TAC wing commander at McConnell AFB, Kansas, noted that Major Boyd had performed in "an extremely outstanding manner" as commander of his manpower management engineering detachment, that his leadership was "outstanding," that he had engaged in various activities to improve himself, including completion of 24 hours of graduate education toward a master's degree to be completed in December 1970, and recommended plaintiff for "immediate promotion to the grade of Lieutenant Colonel."

The deputy base commander at McConnell AFB also spoke in glowing terms of plaintiff's efficiency, his professionalism, his advanced educational efforts scheduled to result in a master's degree in December 1970, initiatives beyond the boundaries of duty, and recommended that since he was "fully capable of assuming greater responsibilities compatible with the rank of lieutenant colonel [that he] should be promoted at the earliest date."

The director of Manpower and Organization at TAC headquarters, Langley AFB, Virginia, was the rating officer. His statement said that under plaintiff's leadership his detachment had functioned in an "excellent manner." He recognized plaintiff's self-improvement efforts and his public relations activities reflecting favorably upon the Air Force. The deputy chief of Plans, Langley AFB, while stating that he had not personally observed plaintiff's duty performance, indicated he was aware of plaintiff's efforts at McConnell AFB and endorsed and concurred in the comments and evaluation of the rating officer.

Neither the rater nor the deputy chief of Plans at Langley AFB had directly supervised plaintiff during the period covered by the OER. Plaintiff was stationed at McConnell AFB in Kansas, while the rater and the deputy chief were at Langley AFB, Virginia. It appears that neither visited McConnell AFB during the period in question. Such a circumstance, however, is anticipated. AFM 36–10(C3), para. 5–9 (1968), provides that where the rater is unable directly to supervise the officer to be rated, he should obtain evaluation letters from the official most familiar with the performance of the officer who is rated. This was done in the instant case by the two evaluation letters from McConnell AFB made a part of the OER.

The heart of plaintiff's argument, and the basis for the Correction Board's favorable recommendations, is that the 7–2 rating received by plaintiff is allegedly inconsistent with the rater's own comments and with the letters of evaluation written by plaintiff's immediate supervisors at the McConnell AFB. The Assistant Secretary, in rejecting the board's recommendations, found no inconsistencies and further stated that any inconsistency between the OER and the evaluation letters would not in any event provide a basis for voiding the OER. Before considering the alleged inconsistencies, we should first recall the standard by which we review the Assistant Secretary's decision.

Pursuant to 10 U.S.C. § 1552, the Secretary, "under procedures established by him," and "acting through boards of civilians of the executive part of that military department," may correct a military record "when he considers it necessary to correct an error or remove an injustice." It is clear from the statute that the Secretary's decision is a discretionary one. The statute is implemented by AFR 31–3, para. 22 (1970), which states:

> 22. *Action by the Secretary of the Air Force.* The record of the Board's proceedings will be forwarded to the Secretary of the Air Force who will direct such action in each case as he determines to be appropriate,

> which may include the return of the record to the Board for further consideration when deemed necessary.

It is thus seen that whereas the Secretary in correcting a military record is to act through a board of civilians, as required by statute, he has by regulation authorized by the statute retained the authority to take such final action on board recommendations as he determines to be appropriate. The regulation is thus not in conflict with the statute. Moreover, another statute, 10 U.S.C. § 8012, gives to the Secretary of the Air Force complete responsibility for conducting all affairs of his department. That section gives to the Secretary authority to delegate his powers to assistant secretaries. Further it states in subsection (e) as follows:

> (e) The Secretary, as he considers appropriate, may assign, detail, and prescribe the duties of the members of the Air Force and civilian personnel of the Department of the Air Force.

We consider this sufficient also to encompass the board of civilians constituting the Air Force Board for the Correction of Military Records. Air Force Order 100.1 assigned to the Assistant Secretary for Manpower and Reserve Affairs the authority to act with the authority of the Secretary in matters of manpower and organization, formulation, review and execution of plans, policies and programs relating thereto, and including the Air Force Board for Correction of Military Records. We adhere to the view expressed in *Proper* v. *United States*, 139 Ct. Cl. 511, 154 F. Supp. 317 (1957), that when he acts to correct a military record (he did not correct one here) it should be through the board. Because of the board's broad authority, its recommendations are entitled to considerable respect. But, as we said in *Proper*, *supra*, 139 Ct. Cl. at 526, 154 F. Supp. at 326, "we do not suggest that the Secretary may not overrule the recommendations of the Correction Board where the findings of that Board are not justified by the record on which the findings were made." *Accord*, *Mercereau* v. *United States*, 155 Ct. Cl. 157 (1961).

The court, in turn, may reject the decision of a Secretary only if he has exercised his discretion arbitrarily, capriciously, in bad faith, contrary to substantial evidence, or where he has gone outside the board record, or fails to explain his actions, or violates applicable law or regulations. Then we will not hesitate to set him right. *Weiss* v. *United States*, 187 Ct. Cl. 1, 5, 408 F. 2d 416, 418 (1969); *Hertzog* v. *United States*, 167 Ct. Cl. 377, 383 (1964); *Eicks* v. *United States*, 145 Ct. Cl. 522, 527, 172 F. Supp. 445, 448 (1959); *Proper* v. *United States*, *supra*, 139 Ct. Cl. at 526, 154 F. Supp. at 326. A decision which is contrary to all evidence would clearly be arbitrary. *Betts* v. *United States*, 145 Ct. Cl. 530, 535, 172 F. Supp. 450, 453 (1959).

Short of such decisional errors, the Assistant Secretary's discretion is not to be interfered with lightly, especially in view of the courts' traditional reluctance to involve themselves in internal affairs of the military, in which they have little or no special competence and less responsibility. *Orloff* v. *Willoughby*, 345 U.S. 83, 94 (1953); *Mindes* v. *Seaman*, 453 F. 2d 197 (1971). The Secretary and selection boards appointed pursuant to his authority, 10 U.S.C. § 8297, are presumed to perform fairly and lawfully in absence of clear and persuasive evidence to the contrary. *Cooper* v. *United States*, 203 Ct. Cl. 300 (1973); *Brenner* v. *United States*, 202 Ct. Cl. 678, 685–86, 692, 696 (1973), *cert. denied*, 419 U.S. 831 (1974). The Secretary found no such evidence to vitiate the selection board decision in the record before the Correction Board or in the rationale of that board's conclusions and recommendations.

The Assistant Secretary's finding that plaintiff's 7–2 rating was consistent with the rater's written comments or "word picture" is unassailable. The "overall evaluation" of a "7" means "excellent, seldom equaled"; the rater describes the functioning of the 4500th Support Squadron (TAC), under plaintiff's leadership, as "excellent." Thus, even the same adjective is used. With regard to "promotion potential" plaintiff was rated as a "2," meaning "performing well in present grade; should be considered for promotion along with contemporaries." No disparity is shown between the rater's laudatory comments and such a rating.

The alleged inconsistency between the OER and the letters of evaluation is a weightier argument, but we are not prepared to reverse the Assistant Secretary's decision that such inconsistency did not exist, or if it did exist, it would be a bad precedent and contrary to his policy that forbids letters of evaluation by local commanders from being binding on the rating officer and thus guaranteeing promotion regardless of all other factors the rating officer must consider on a broader basis. The evaluation letters referred to plaintiff as "outstanding," while the OER rated plaintiff as "excellent, seldom equaled." As the Assistant Secretary pointed out, the rating "excellent, seldom equaled" is further defined in AFM 36–10 (C2), para. 6.5 (1968), to mean an "officer whose exceptional performance is worthy of special notice. He must perform most aspects of his job in an outstanding manner." The next higher rating (an "8") is defined as follows:

> (8) *Outstanding, Almost Never Equaled.* Rating in this box must be reserved for those very few officers, whose performance, initiative, leadership, and personality set them apart *as having the potential for high staff or command assignments.* [Emphasis supplied.]

Plaintiff's endorsements did not suggest plaintiff had the potential for such command. It may be seen, therefore, that plaintiff's rating of "7" ("perform[s] most aspects of his job in an outstanding manner") cannot be found clearly inconsistent with his evaluation as "outstanding" by his base commanders. Nor can it be said that plaintiff was clearly entitled to higher rating or promotion just because he was recommended for it by his base commanders. As the Secretary said, that "would be to hold that the local commanders may usurp the assigned function of the rater, and that would be to pervert the OER system."

The Assistant Secretary acted within his discretion, as well, when he failed to find a discrepancy between the rater's recommendation that plaintiff be promoted along with his contemporaries and the evaluation letters which recommended promotion "at the earliest date" or "immediate promotion." As was pointed out by the Secretary, immediate promotion in the circumstances of this case would have been promotion with contemporaries. Furthermore, the Assistant Secretary stressed that the rater is the only official with the responsibility and opportunity to compare plaintiff with other officers. For instance, if all majors were recommended for promotion, or more were recommended than authorized for appointment, the rater must attempt to ascertain which are best qualified. This comparison function of the rater applies equally, of course, to plaintiff's "overall evaluation" discussed above.[3] Under the Air Force Manual 36–10, para. 6–5 (1967), the rating officer is charged with making "each judgment * * * only in comparison with other officers serving in the same grade at the time the report is made." The Assistant Secretary's decision stated, in part:

> * * * And as the TAC Officer Evaluation Report Review Board noted, the rater was well qualified in the manpower field and was obviously better qualified to evaluate the applicant in his primary responsibility, manpower-management, than the local commanders; he was in a position to compare the effectiveness of the unit under the applicant's leadership with other manpower detachments throughout TAC and to know how the applicant responded to TAC requirements. * * * the rater had comparative performance information available to him which the local commanders did not * * * which could well account for any shadings of difference in the evaluations.

The Secretary, however, found no significant disagreements between the rater's evaluation and the letters of evaluation which required explanation or justification, and neither do we.

It follows that since the Assistant Secretary acted with reasonable discretion in upholding the validity of the OER, he was acting properly and within his statutory authority in rejecting the Correction Board's recommendations that plaintiff be promoted to lieutenant colonel and restored to active duty. Since there is no basis for voiding the OER, there is no basis for agreement with the Correction Board in overriding the selection board's action in not selecting plaintiff for promotion. It might be noted that even had the OER been voided, or had plaintiff been rated more highly, there was no assurance that plaintiff would have been promoted. The function of the Secretary and of a selection board as to appointments and promotions is discretionary and their actions cannot be presumed. *Cooper* v. *United States*, *supra; Clinton* v. *United States*, 191 Ct. Cl. 604, 423 F. 2d 1367 (1970). At least five selection boards at one time or another had deferred plaintiff for promotion although at one time a board had before it the three highest ratings plaintiff had received in his military career—8-4, 8-3, and 8-3.

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[3] An inconsistency between the evaluation letters and the OER is suggested by plaintiff. The letters noted that plaintiff's application for a master's degree had been approved for December 1970 completion. The OER, on the other hand, stated only that plaintiff had completed 22 hours towards his master's degree. If there is any inconsistency here, it is *de minimis*. Plaintiff had not qualified for his degree during the period covered by the OER. Furthermore, plaintiff had the right to notify the selection board of the fact that he had attained the degree. 10 U.S.C. § 8297(e). The board met on March 1, 1971. The court record does not show when the degree was actually awarded, but the potential award was in the rater's knowledge, noted by him, and thus before the selection board.

The fact that plaintiff has been passed over signifies no disrespect to him. His military record appears, from all the papers before us, to have been exemplary in every respect. Numerous worthy and qualified officers are passed over annually and never reach the top in their profession. They may be qualified but—in the judgment of the Secretary and the selection board vested with discretionary authority to make the promotions—may not be the best qualified of those available for the limited number of positions. The same problem can be said to confront other ambitious professional people. There are fewer rungs as one climbs toward the top of the achievement ladder. Not only are manpower requirements a factor but appropriations also sometimes have a bearing on availability of opportunities in the Government service. We have not been shown here that any officer with a record comparable to plaintiff's was promoted ahead of him. There is no showing of bias or prejudice here which might suggest an error or injustice in selection board proceedings. Indeed, we note in passing that the Secretary on two prior occasions—in 1968 and in 1970—did sustain the Correction Board recommendations to correct plaintiff's OER's. This tends to show that where justified by the evidence plaintiff has been granted relief administratively and that he has not been singled out by the Secretary for unfavorable treatment.

The Correction Board's conclusion in plaintiff's favor, based entirely on what it described as "reasonable doubt whether he did in fact receive a just and equitable consideration by the permanent lieutenant colonel selection board" does not withstand the contrary analysis and conclusion made in good faith, within the law, and without arbitrariness or caprice by the Assistant Secretary in the present case. To change a record upon such a tenuous basis would be without support in law, unjustified, and unfair to others who in all probability have been passed over with qualifications similar, or superior, to plaintiff's. In sum, we cannot find upon careful examination of the considerable record in this case, that the Assistant Secretary acted unlawfully in rejecting assertions of alleged inconsistencies in plaintiff's OER and lack of support for it in the letters of evaluation, and in refusing to reinstate or to promote plaintiff contrary to selection board determination. We cannot predicate a judgment here based on a mere nuance as to a rating, which is a debatable one at best. Ratings and promotions are discretionary matters with which the court will continue to be "scrupulous not to intervene" unless clear error is shown or relief is mandated by law or regulation. *Orloff* v. *Willoughby*, *supra* at 94; *Yee* v. *United States*, 206 Ct. Cl. 388, 512 F. 2d 1383 (1975); *Dorl* v. *United States*, 200 Ct. Cl. 626, *cert. denied*, 414 U.S. 1032 (1973). There is no legal basis for any of plaintiff's claims.

Defendant's motions to dismiss and for summary judgment are granted. Plaintiff's cross-motion for summary judgment is denied. The petition is dismissed.

NICHOLS, *Judge*, concurring:

I concur in the result. Respectfully, I venture to differ with the court's reasoning on only one or two points, though agreeing with most of what it has to say.

The Act, 10 U.S.C. § 1552, for Correction of Military Records, was passed in 1946 in course of an ambitious effort in legislative reorganization, to delegate the function of considering what had been private bills passed upon, at least theoretically, by the entire Congress. The Indian Claims Commission Act, 25 U.S.C. § 70a and ff., also was born in the same spasm; the two Acts are twins in other respects than that both make this court a lot of work. In view of their origin, both must be regarded as delegating legislative authority. Both call for recognition and enforcement of moral obligations, which is primarily a legislative function. *United States* v. *Realty Co.*, 163 U.S. 427 (1896). Normally the legislature transmutes moral obligations into legal, which judicial and quasi-judicial tribunals then enforce. Here the two functions are merged into one.

In 1946 the citizen soldiers and sailors drafted to fight World War II were pouring back into civil life. The feeling—right or wrong—was that many of them might be handicapped by bad military records created without due process in the hurly-burly of the war, and that the career military who would remain in charge at the Pentagon would not be much interested in effecting corrections. Hence the provision that the Service Secretaries should act "through boards of civilians". I have never had explained to me just what that language means. On the one hand, the legislative purpose would appear to be frustrated if the Board members are simply part of the Secretaries' staff advisers, to be overruled at pleasure. On the other, it has never been held that he must delegate full authority to the civilian Board, as he does with Wunderlich reviews of contract disputes. That Act, 41 U.S.C. § 321–22, offers more sweeping protection to the citizen against military absolutism in his capacity as contractor, than the Correction Board legislation affords him in his capacity as a uniformed military employee, possibly an involuntary one. But the latter Act must be construed to accomplish some purpose, in everything that it says. It could have said the Secretary could correct military records, taking advice from whatever source he pleased. When Congress said he was to do it through a civilian Board, this must have had a meaning. *Proper* v. *United States*, 139 Ct. Cl. 511, 154 F. Supp. 317 (1957). *See*, *Ogden* v. *Zuckert*, 298 F.2d 312, 316 (D.C. Cir. 1961).

In light of the foregoing the Air Force regulation, AFR 31–3, is notably silent as to whether the Air Force Secretary is required to attach any weight to Board decisions. This presents at least a potentiality of frustrating the Congressional intent, and explains the care with which we always, as here, scrutinize a Secretary's decision overruling a Correction Board. A declaration of the guidelines the Secretary follows in performing his review function would ease our task considerably. It is true the Secretary also is a civilian, but he is so dependent on his military subordinates that this fact alone is often, as in the legislation here involved, not deemed enough to effectuate our constitutional supremacy of civilian over military authority. If we find the overruling of the Board was achieved by or through a military adviser, the action is set aside. *Weiss* v. *United States*, 187 Ct. Cl. 1, 408 F. 2d 416 (1969); *Proper* v. *United States*, *supra.* The court cites three other instances, before *Weiss*, when we reinstated a Board decision after a Secretary had overruled it. *Hertzog* v. *United States*, 167 Ct. Cl. 377 (1964); *Betts* v. *United States*, 145 Ct. Cl. 530, 172 F. Supp. 450 (1959); *Eicks* v. *United States*, 145 Ct. Cl. 522, 172 F. Supp. 445 (1959). In those cases, the Secretary's decision appeared arbitrary in face of the Board record and the facts that the records showed; therefore, even if the Board had recommended that the Secretary do what he did, reversal of the Secretary would very likely have been our decision. I do not read the decisions as affording any help as to what was added to the Secretary's duty to take a particular action by the fact the Board recommended he take it.

I am inclined to think the Secretary can and should reject a Board recommendation when he observes upon review that it is contrary to law, arbitrary and capricious, or not supported by substantial evidence. These are our review standards. *Cooper* v. *United States*, 203 Ct. Cl. 300 (1973). He must, however, recognize that the Board is, within reasonable limits, a policy-making body. It is for the Board, given a state of facts, to say if it is an error or injustice. Its discretion must be broad even if not unlimited. The Secretary may not reverse it merely because his nose for injustice is less sensitive than the Board's. In my view, however, a Board decision is contrary to law if it runs up against the declared policy of a law, *i.e.*, its charter does not include the power to go around overriding other laws *ad lib.* *See*, *Mayer* v. *United States*, 201 Ct. Cl. 105, 107 [Nichols J., concurring] (1973).

The use of Selection Boards to select regular officers for promotion (10 U.S.C. § 8297) and the retirement of those not selected (10 U.S.C. § 8303) are basic to the performance of the Air Force mission. It is a highly sensitive and discretionary function. We were told that the Selection Board plaintiff complains of had to pass over 20% of the names before it. These Boards and the way they operate are just as much products of the Congressional will as Correction Boards are. I do not believe either one is entitled to override the other. A Selection Board decision based on a misleading and unjust record cannot stand, *Weiss*, *supra*, but if it is legally made within the Selection Board's powers, it is the duty of the Secretary to defend it against all interference. The Correction Board here would have promoted plaintiff though it had no information in its record to show his qualifications were superior to those of others who were passed over, and I judge that sooner or later, because of the limited number of slots, someone else would not have been promoted, if plaintiff was, which other person could, so far as the Correction Board knew, perfectly well have had superior qualifications to the plaintiff's.

Plaintiff had able and persuasive counsel who made the most of what appears to me to be a weak case, weak for reasons well analyzed by Judge Bennett. It is impossible to find any clearcut falsity or unjust derogation of plaintiff in the O.E.R. under attack, on careful study of it in chambers. The Secretary's analysis was essentially the same as ours. Having made it, he had to draw the conclusion that the Correction Board would interfere with the Selection Board in a matter within the the latter's exclusive jurisdiction. I do not view this as a discretionary decision; it was one it was his duty to make. Had he analyzed the facts as the Correction Board did, his duty would have been different, but such an analysis would have been hard to defend. The substantial evidence rule was not available to sustain the Board. The evidence in the record was undisputed and the result turned on the interpretation of documents. I am not, of course, saying that a promotion would be *ultra vires* for the Correction Board under all circumstances.

My difference with Judge Bennett is that I see the matter as more governed by law and less governed by executive discretion than he does.

Plaintiff clearly was an officer of great value to the Air Force and one may hope that, even now, some way may be discovered to make use of his services. The undermining of the Selection procedure is, to me, just simply not the way to go about it. It does more wrong than it rights.

## WALTER J. SAMPSON, BERNARD GREENBAUM, ABNER J. MESIROW, AND ARTHUR A. BOGEAUS, CO-PARTNERS, d/b/a SOUTHEASTERN INDUSTRIAL DEVELOPMENT DISTRICT, PLAINTIFFS, AND THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES, PLAINTIFF-INTERVENOR v. THE UNITED STATES

[No. 379-68. Decided May 14, 1975]*

ON PLAINTIFF-INTERVENOR'S MOTION AND PLAINTIFFS' CROSS-MOTION FOR SUMMARY JUDGMENT

**Mortgages; construction and operation; rights and liability of parties; lease; estoppel by deed; rehabilitation damages.**—This case was originally filed seeking rehabilitation damages after breach of a 1952 agreement leasing space in the Chimes Building, Syracuse, New York, to defendant. The court determined that defendant was liable for $292,574.26, and the issue now before the court is whether the judgment belongs to plaintiff (SID) or to plaintiff-intervenor (Equitable) (first mortgage by a deed of trust), i.e. whether a 1954 mortgage made a valid assignment of the rehabilitation damages to Equitable. Under Clause 20 of the mortgage SID assigned to Equitable any and all awards made to present and future owners of the mortgaged premises. In 1966 the mortgages of Equitable and Irving Trust, a second mortgagee, were in default. In March 1967 City Investing Company (CIC) became assignee of Irving and commenced foreclosure proceedings. SID and Equitable had engaged in condemnation litigation instituted by the United States to acquire use of part of the Chimes Building, the court in 1969 holding CIC entitled to all of the compensation due from the United States. Equitable claimed entitlement only in event SID received any part of the compensation. New York law requires and Equitable in fact was a party to both the foreclosure and condemnation pro-

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*See decision of the court sitting *en banc* decided January 28, 1976, 208 Ct. Cl. 656, reversing the decision of May 14, 1975.

ceedings. In 1967 negotiations among SID, Equitable and CIC resulted in a series of bargained agreements, whereby, *inter alia*, SID provided CIC a deed in lieu of foreclosure and assigned to CIC the rental condemnation damages award. In the transfer by deed from SID to CIC, Equitable waived its rights to oppose the transfer under the mortgage by failure to object on time either in the foreclosure dismissal or the condemnation proceeding decision. On July 30, 1968 the new owner of the building and Equitable entered into a novation of the 1954 mortgage in which Equitable recited that there were "no offsets, set-offs, defenses or counterclaims against the Mortgage notes and mortgages and the monies due thereunder." It is *held* that Equitable's claim fails because Clause 20 is inapplicable to the case for failure to meet the condition precedent of a current mortgage debt of SID's to apply the award to (under Clause 20), and for the New York law application of estoppel by deed by Equitable's holding out that it had no such offset (as the rehabilitation damages) to amounts due Equitable under its mortgage with the new owner on the Chimes building. Plaintiffs' motion for summary judgment is granted, the cross-motion of plaintiff-intervenor is denied, the intervening petition is dismissed and the previous judgment for plaintiffs is reaffirmed.

**Mortgages; construction and operation; rights and liability of parties.**

[1] Although the owner of a building (SID) in entering into a mortgage agreement with E assigned to E under Clause 20 as collateral security for the debt any and all awards made to present and future owners of the premises, where the facts are conclusive that SID's liability was not personal but was restricted to ownership of the building itself, where E acquiesced in agreements with SID and the second mortgagee (CIC), who had accepted SID's deed in lieu of foreclosure, by which CIC took full possession and title to all of SID's interest in the premises except to compensation for leasehold rehabilitation damages, and where in subsequent condemnation proceedings E waived its priority over CIC and at the same time reserved no rights to the rehabilitation damages, E in effect discharged the only liability SID had on the mortgage and since Clause 20 requires a debt as a condition precedent E is not entitled to share in the rehabilitation damages award.

Mortgages ⚿ 315(1)

**Estoppel; estoppel by deed; New York law.**

[2] Where the court has concluded that under certain agreements the mortgagee waived any claim to the mortgagor's leasehold rehabilitation damages award, under New York law the doctrine of estoppel by deed applies to bar the mortgagee from challenging its own statement in a novation of the mortgage with the new owner of the premises that it had no offset (such as the rehabilitation damages) to amounts due it under the mortgage.

Estoppel ⚿ 32(3)

*John B. Carroll*, attorney of record for plaintiffs. *Carroll, Carroll & Butz*, of counsel.

*Hershel Shanks*, attorney of record for plaintiff-intervenor. *Michael S. Marcus*, *Philip J. Ufholz* and *Glassie, Pewett, Beebe & Shanks*, of counsel.

*Herbert Pittle*, with whom was *Assistant Attorney General Wallace H. Johnson*, for defendant.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and NICHOLS, *Judge*.

NICHOLS, *Judge*, delivered the opinion of the court:

This suit was originally brought by Sampson and his partners, doing business as Southeastern Industrial Development District (SID), for $750,000 rehabilitation damages to premises owned by SID and leased to the United States from December 3, 1946 to December 31, 1966. There was a trial in October 1972 before Trial Judge Spector, in which plaintiffs prevailed, and subsequently by order of the court of June 28, 1974, recovered judgment for $292,574.26. A dispute remains between plaintiff SID and its former mortgagee, Equitable Life Assurance Society of the United States (Equitable). Equitable had intervened in 1971 and plaintiffs moved to dismiss the intervention. Action on this motion was deferred until after decision on the merits and we must now decide it. Both sides have now moved for summary judgment.

## I

The starting place for stating the facts is the trial judge's opinion. The claim was on the usual tenant's covenant to restore the premises at the end of the tenancy to their condition at the beginning. The 1946 lease involved the general multistory Chimes office building in the downtown area of Syracuse, New York. In 1946 the Chimes building was one of the three leading office buildings in Syracuse, having been built about 1928. Government occupancy led to "extensive demolition and removal of corridors, walls and partitions which had theretofore defined the pre-existing, multi-tenant general office space." "Other areas were altered into small highly compartmented interviewing cubicles by means of half-partitions. Existing incandescent electric light fixtures were removed and replaced with about 900 large fluorescent fixtures suspended from the ceiling. They are not suitable for multi-tenant commercial offices, such as had pre-existed."

In addition, the interior terrazzo floors, bronze elevator doors, marble and wood fixtures, all had been permanently and extensively damaged by the Government occupancy. Plaintiffs' experts testified to total restoration damages of $585,148.52 (excepting reasonable wear and tear). The trial judge by way of a "jury" verdict reduced the award claim 30% for other causes of the damage and 20% for "betterment" to the building involved in the necessary replacement of old irreparable fixtures by new ones. Thus the trial judge made the uncontested award of $292,574.26 over which plaintiffs and their former mortgagee now do battle.

The trial judge's finding 46 also stated: "It is concluded that the Chimes building was not rentable at all under the conditions prevailing at the expiration of the lease in 1966. Restored to rentable condition, there would have been a strong demand for multi-tenant space * * *."

There was no appeal from the trial judge's findings and we affirmed without further comment by order on June 28, 1974, 204 Ct. Cl. 920.

## II

The dispute between SID and Equitable is whether a 1954 mortgage made a valid assignment of these rehabilitation damages to Equitable. Clause 20 of the 1954 mortgage gives rise to Equitable's claim.

> 20. The party of the second part for themselves, their heirs, legal representatives, successors and assigns, does hereby assign to said party of the first part, its heirs, legal representatives, successors and assigns any and all awards heretofore made and hereafter to be made to the present and all subsequent owners of the mortgaged premises, including any award and awards for change of grade of any street affecting said mortgaged premises, and said party of the first part, its heirs, legal representatives, successors and assigns is hereby authorized and empowered to collect and receive such award and awards and to give proper receipts and acquittances

> therefor, and to apply the same toward the payment of the amount owing on said bond and mortgage, notwithstanding the fact that the amount owing on said bond and mortgage may not then be due and payable, and said party of the second part for themselves, their heirs, legal representatives, successors and assigns hereby covenants and agrees with said party of the first part, its heirs, legal representatives, successors and assigns upon request to make, execute and deliver any and all assignments and other instruments sufficient for the purpose of assigning said award and awards to the holder of said bond and mortgage, free, clear and discharged of any incumbrances of any kind or nature whatsoever.

SID and Equitable have engaged in previous litigation reported as *United States* v. *Certain Space*, 320 F. Supp. 491 (N.D.N.Y. 1969), *affd*, 435 F. 2d 872 (1970), *cert. denied*, 402 U.S. 908 (1972). This was a condemnation the United States instituted to acquire the use of part of the premises in the Chimes building it had previously leased, for a further period, eventually ending November 30, 1967. The just compensation being uncontested as to amount, and part being on deposit in the registry of the court, the above reported decision allocates it among the claimants, holding that City Investing Company (CIC) should take it all. Equitable claimed only in case SID received any of it, in that case invoking the above mentioned Clause 20. Since SID took nothing, neither did Equitable. The parties here did not even mention that decision, still less offer the record therein or any of it as evidence. We think some of the findings in that case, and documents reproduced and published therein, are relevant here, and we refer to them hereinafter as appears. Perhaps we should reopen the record to receive this material but we think our references are proper under established doctrines of judicial notice and collateral estoppel, especially since we are deciding under the summary judgment procedure.

Equitable was first mortgagee by a deed of trust dated April 1, 1954, which consolidated and replaced earlier agreements. There was a second mortgage to Irving Trust Co. and in 1966 both were in default. In March 1967 CIC became assignee of Irving Trust Co. and commenced a foreclosure in the state court, but in October 1967, CIC accepted SID's deed in lieu of foreclosure. CIC and SID agreed between themselves that the award for condemnation of the leasehold would belong to CIC and the damages, if any, recoverable on the restoration claim to SID. The defendant United States was aware of this agreement and undertook not to set it up as a defense under the Anti-Assignment Act, 31 U.S.C. § 203, which agreement has been honored. It is apparent that Equitable was aware of it also and that its acquiescence in the pocketing of the condemnation award by CIC, notwithstanding Clause 20, reflected other measures taken by CIC to assure Equitable that its security was not impaired.

The following facts are clear: A series of negotiations among SID, Equitable and CIC in 1967 resulted in a series of bargained agreements:

> A. A September 14, 1967, letter from CIC to SID stated that the restoration and rehabilitation damages involved here "are reserved to you" (SID) and stated that they were not covered by the assignment of the rental condemnation damages to CIC.
>
> B. SID provided CIC a deed to Chimes building which was recorded on October 17, 1967.
>
> C. SID further assigned on October 2, 1967, the rental condemnation damages award ($178,700) to CIC.

The tradeoffs as reflected in *Certain Space* and the parties' motions and supporting documents were as follows:

*Benefits to SID:*

(1) $10,000 cash;
(2) sole retention of rights to rehabilitation damages (then mistakenly valued at about $7,000);
(3) sole retention of "loss of equity" damages claim (apparently worthless);
(4) it walked away from its losing investment in the Chimes building without personal liability;

*Benefits to CIC (and Equitable):*

(1) title transfer without one-million-dollar state-foreclosure title-transfer tax;
(2) receipt of rental condemnation award damages ($178,700 cash);
(3) transfer of title to 2.2 million dollar building to second mortgagee—now new owner.

These additional facts are also established:

> (a) The July 30, 1968, novation of the 1954 mortgage (in which Investors Funding Corp. replaced SID and new borrowing terms and amounts were fixed by agreement with Equitable) discharged SID from all remaining obligations if any to Equitable, other than the Clause 20 in issue.
>
> (b) The original 1954 mortgage agreement limited SID's liability to its interest in and value of the Chimes building.
>
> (c) The disputed Clause 20 was construed as a "condemnation clause" by District Judge Port in denying SID any part of the condemnation award but "the rights or remedies of SID outside of the award, if any, remain undisturbed."

The District Judge did not specifically find Equitable's full involvement with CIC but we note that CIC was junior to Equitable (second mortgage is junior to first mortgage); that New York law requires and Equitable in fact was a party both to the foreclosure proceeding and to the condemnation proceeding; that in the condemnation proceedings Equitable patently waived its priority over CIC; and that in the transfer by deed from SID to CIC, Equitable also waived its rights to oppose the transfer under the mortgage by failure to object on time either in the foreclosure dismissal or condemnation proceeding decision.

## III

Taken literally, Clause 20 would assign to Equitable any and all "awards" made to the mortgagor, whether or not they had anything to do with the mortgaged premises. Yet Equitable would not argue that Mr. Sampson was obliged to assign an award made to him by the Jaycees as "business man of the year." One reads on and sees that the Clause purports to bind subsequent "owners of the mortgaged premises." This indicates strongly that the "awards" are only those made to a person in his capacity as owner or, say, in respect to his ownership. If the title passes to another, subject to the mortgage, the former owner would remain obliged only with respect to awards to him, and the new one only with respect to awards to him, all to the extent and only to the extent they were awards with respect to ownership. It is, therefore, a possible question whether an award that, absent agreement, would pass to a former owner is within the meaning of Clause 20. There is at least some ambiguity as to that. If the former owner and the new owner agree that the former owner, not the new one, shall receive any particular award, this shows an understanding by them that the award is not made with respect to ownership, but is a personal asset of the prior owner. Such an understanding would not bind the mortgagee if he was not aware of it, but if he was aware, and made no protest, this would tend to show that his understanding of the meaning of Clause 20 was the same as that of both the new and the old mortgagors. Here the mortgagee not only made no protest, but was a party to a tri-lateral series of transactions, of which the retention of the restoration claim by the SID group was an integral part. Thus we think the practical construction of all the parties supports the conclusion that Clause 20 was not meant to cover a claim by the former mortgagor against a former lessee for damages for breach of a convenant in the lease, even if it does cover some other things than condemnations. If the rehabilitation damages had been deemed part of the Clause 20 security, all parties would have agreed they should pass to the new mortgagor. While the waste committed by the Government impaired Equitable's security to some extent, the deal contemplated making this good with funds obtained otherwise than from the Government. Counsel before us seemed all to agree that, antecedently considered, the claim against the Government looked like an extremely long shot.

## IV

We can be helped a little more in the construction of Clause 20 by Judge Port's calling it a condemnation clause, and as such, it served the function of protecting the mortgagee from loss of his security as the result of condemnation proceedings, and other proceedings of the same general character. It gave Equitable a claim to monies that stood in the place of the mortgaged premises. Consequently if the mortgagee, as here, has subsequently discharged the mortgagor, prior to any award and without reserving any rights in the award, the mortgagee can take no share in the award. We reached a similar conclusion in *Beaconwear Clothing Co.* v. *United States*, 174 Ct. Cl. 40, 52, 355 F. 2d 583, 590 (1966). In *Beaconwear* the terms of the assignment were similarly broad and absolute in style, but the bank had already discharged the debt by payment—and consequently the assignment was held to be void as to any further obligations. We said at 52, 355 F. 2d 590:

> * * * Generally, an assignment made as collateral security for a debt gives the assignee only a qualified interest in the assigned chose, commensurate with the debt or liabilities secured, even though the assignment appears to be absolute on its face. * * *

Here the facts are conclusive that the mortgagor SID's liability was not personal but was restricted to the building itself—and that Equitable at the very least acquiesced in a series of agreements by which the second mortgagee took full possession and title to all of SID's interest in the building—in effect discharging the only liability SID had ever had on the mortgage. The subsequent novation of the mortgage with the new owners confirms this discharge analysis. Consequently, absent any right or title against SID under the mortgage (*i.e.*, no debt), Equitable is without any rights against SID under Clause 20 which requires a debt as a condition precedent. *Beaconwear*, *supra.*

## V

While it is not as clear as could be, the whole tenor of Judge Port's opinion suggests to us that Equitable is seeking to litigate an issue on which it is estopped. The October 2, 1967, assignment of the right to the condemnation award, from SID to CIC, quoted by Judge Port in footnote 3 at 494, *supra*, conflicts with the obligation of SID and assumed by CIC under Clause 20. It is clear from the decision that Equitable waived this breach. But it also seems to be the more likely conclusion that Equitable waived its rights to the rehabilitation award at the same time. All the subsequent events bear out the conclusion that Equitable tacitly acquiesced in CIC's agreements with SID in their entirety until March 12, 1971, when Equitable suddenly discovered

SID's "worthless" claim was supported by a $750,000 estimate and Equitable's new mortgagor Investors Funding Corp., was going bankrupt.

The conclusive support for this theory is contained in Equitable's own deed of July 30, 1968. At the bottom of the very first page, Equitable recites that there are "no offsets, set-offs, defenses or counter-claims against said Mortgage notes and mortgages and the monies due thereunder". These were the mortgages originally made by SID, but CIC was now the substituted mortgagor. If Equitable were truly due the monies from our judgment by virtue of Clause 20, they would also constitute "offsets" against the monies due from CIC under the mortgage. It is inconsistent for Equitable to seek full payment from Investors Funding under the mortgage novation of July 30, 1968, and to also seek the same money from SID—all the while denying the existence of offsets, set-offs, defenses, and counter-claims.

Even if we did not believe that the July 30, 1968, mortgage novation clearly reflects the understanding of Equitable in light of the 1967 agreements (*i.e.*, that Equitable waived any claim to SID's rehabilitation damages award in the 1967 agreements), the New York law applies the doctrine of estoppel by deed to bar Equitable from challenging its own statement of the facts in its mortgage, *Van Winkle* v. *Van Winkle*, 95 App. Div. 605, 89 N.Y.S. 26 (1904) *aff'd*, 184 N.Y. 193, 77 N.E. 33 (1906).

Therefore Equitable's claim falls because Clause 20 is inapplicable to the case, for failure to meet the condition precedent of a current mortgage debt of SID's to apply the award to (under Clause 20), and for estoppel by deed by Equitable's holding out that it had no such offset (as these damages) to amounts due Equitable under its mortgage with Investors Funding on the Chimes building.

The parties have debated quite a number of other issues, but our analysis of the legal effect of Clause 20, given above, makes it unnecessary for us to go into them, and we therefore refrain from doing so.

In view of the foregoing, after consideration of the motions of the parties and the briefs and arguments of counsel, the plaintiffs' motion for summary judgment is granted and the intervening petitioner's motion for summary judgment is denied. The intervening petition is dismissed and the previous judgment for the plaintiffs is reaffirmed.*

515 F. 2d 1397

## DONALD J. BOYLE v. THE UNITED STATES

No. 97-73

## KATHLEEN S. PAASCH v. THE UNITED STATES

No. 98-73

[Decided May 14, 1975]

### ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; dismissal.**—Plaintiffs were dismissed from their employment as Historians, GS-11, in the Joint Secretariat of the Joint Chiefs of Staff, Department of Defense, and seek reinstatement in their former positions and back pay. Plaintiffs were dissatisfied with conditions under which they worked and were of the opinion that management had failed to establish full and effective control and direction over the work in their division, and that management practices and procedures rendered it impossible for them to attain professional standards. They requested a desk audit (which is ordinarily employed for determining whether a civilian employee's position is properly classified under Civil Service Commission position classification standards) and as a result it was concluded that plaintiffs' positions were correctly classified. Plaintiffs' efficiency and productivity declined, and for about 6 months they were idle except for time spent on aspects of their grievance and in drafting complaints, although they did not file a formal grievance against their supervisors. Plaintiffs also claim that certain personnel actions (such as denial of Boyle's in-grade raise and institution of a 6-month trial period of assignments at GS-12 level for both plaintiffs which they categorize as acts of harassment and reprisal) had an adverse impact on their morale and their ability to carry out their work assignments. Plaintiffs were served with a notice of proposed removal for failure to perform assigned duties, were subsequently dismissed, and appealed unsuccessfully to the Civil Service Commission and to the CSC Board of Appeals and Review. They claim that the decision to dismiss them was arbitrary and capricious and that their removal was procedurally defective. It is *held* (1) that while plaintiffs did not have good working relationships with their supervisors, dissatisfaction over management practices does

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*See footnote, page 17.

Syllabus

not constitute sufficient ground to justify work stoppage; that the posture of the supervisors was not malicious or hostile, nor were the personnel actions taken by them acts of reprisal; (2) that the decision to remove plaintiffs for failure to perform assigned duties was not arbitrary, capricious or unsupported by substantial evidence; and (3) that there is no merit to the contention that plaintiffs were not given a fair hearing by the CSC Appeals Examining Office. Plaintiffs are not entitled to recover, their motion for summary judgment is denied, defendant's cross-motion is granted, and the petitions are dismissed.

**Civilian pay; Court of Claims jurisdiction; administrative or executive decisions; review of by court.**

[1] Where an administrative agency has complied with the prescribed procedural requirements, the Court of Claims can only review the action to determine whether the officials who effected the dismissal acted arbitrarily, capriciously or were so grossly erroneous as to be in bad faith, as for instance where they may have acted without substantial evidence to support their decisions or where they exceeded their authority.

**Courts ⟹ 465**

**Civilian pay; Court of Claims jurisdiction; administrative or executive decisions; review of by court.**

[2] In entertaining a suit to recover loss of pay brought by a dismissed federal employee, it is not the function of the court to substitute its judgment for that of the employing agency or the Civil Service Commission; rather the court reviews the case to determine whether their action was reasonable in light of all the evidence.

**Officers ⟹ 72(2)**

**Civilian pay; presumptions; official actions of Government officials; presumption of regularity.**

[3] The presumption in this court's review of dismissals of federal employees is that the Government officials have acted in good faith in making their decision which will be upset judicially only where it is shown that the officials abused or exceeded their authority, where the result is not supported by substantial evidence or the decision is contrary to law or regulation.

**United States ⟹ 36**

**Civilian pay; classified Civil Service; duty and obligation of employees.**

[4] The prime duty and foremost obligation of any employee is to exert effort and energy in the accomplishment of assigned tasks. Those in the working force have a legitimate interest in seeking to better their working conditions, and to that end an employee has a right to express his dissatisfaction to those in positions of higher authority, but he is not free to neglect or refuse to perform assigned duties merely because of disagreements with management.

If he fails to perform his duties, he does so at the risk of being insubordinate.

United States 🔑 41

**Civilian pay; dismissal; Civil Service Commission procedures; charges and reasons for dismissal.**

[5] Where the letter of proposed removal cited plaintiffs' failure to perform assigned duties and they were specifically charged with not applying themselves to their work to the extent required of employees in their positions, the conclusion that plaintiffs deliberately stopped working does not amount to the formulation by the Hearing Examiner of a new charge against plaintiffs, particularly where the conclusion finds ample evidentiary support in the record.

United States 🔑 36

*David Rein*, attorney of record, for plaintiffs.

*Donnie Hoover*, with whom was *Assistant Attorney General Carla A. Hills. Leslie H. Wiesenfelder*, of counsel.

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Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and NICHOLS, *Judge*.

DURFEE, *Senior Judge*, delivered the opinion of the court: This civilian pay case involves the dismissal of two historians, GS–11, from their employment in the Joint Secretariat of the Joint Chiefs of Staff, Department of Defense. Plaintiffs unsuccessfully challenged their discharges in an appeal to the Civil Service Commission. Having exhausted their administrative remedies, they jointly petition this court to reinstate them in their former positions and to award them back pay. We have jurisdiction under 28 U.S.C. § 1491. The case is before us on the parties' motions for summary judgment since the pertinent and controlling facts are not in dispute.

Donald J. Boyle commenced employment with the Government as an historian, GS–9, on May 27, 1968; he was promoted to grade GS–11 on June 1, 1969, and was given an increase within grade on May 31, 1970. Kathleen S. Paasch started her employment with the Government as an historian, GS–7, on November 14, 1966; she was advanced to grade GS–9 on November 19, 1967, and to Grade GS–11 on December 1, 1968, and was given increases within grade on November 30, 1969, and again on December 13, 1970. Both Boyle and Paasch were engaged, along with others in the Historical Division, in the preparation of a multi-volume history of the Joint Chiefs of Staff.

At some point in time Boyle and Paasch became discontented with the conditions under which they were working, although the origins of their dissatisfaction are not entirely clear. Plaintiffs were primarily troubled about their work relationship with the senior historians of the Historical Division. Both of them felt that their assignments had been poorly planned and delineated, and on several occasions they registered the complaint that they were receiving insufficient guidance and inadequate supervision from their overseers. On October 9, 1970, Boyle and Paasch jointly submitted a request for a desk audit, the procedure ordinarily employed for determining whether or not a civilian employee's position is properly classified under Civil Service Commission position classification standards. It was plaintiff Paasch's hope that the requested audit would "verify that the junior-senior arrangement as practiced in the Histories Branch was at best a fiction and actually constituted mismanagement." According to plaintiff Boyle, the October 1970 desk audit was a "legitimate tool * * * to determine whether or not I, indeed, was working at the level beyond my position description, GS-11." The results of the requested desk audit were handed down and transmitted to plaintiffs by a memorandum, dated November 4, 1970; it was concluded that plaintiffs' positions were correctly classified as Historian, GS-11.

Boyle and Paasch continued to express their dissatisfaction over the imbalance which allegedly prevailed in their department. While plaintiffs' complaints often lack specificity—so that the precise nature of the dispute with management is somewhat unclear—there is a recurring theme which can be gleaned from an investigation of the letters, memoranda and other evidence in the record: plaintiffs were of the opinion that management (i.e., the senior historians) had failed to establish full and effective control and direction over the work in the Historical Division; it was plaintiffs' belief that management practices and procedures rendered it impossible for them to attain professional standards. It will be observed that plaintiffs did not at any time file a formal grievance against their supervisors in accordance with appropriate Civil Service Commission regulations.

The controversy between plaintiffs and their supervisors had a serious impact upon plaintiffs' work efficiency and productivity. Plaintiffs' achievement level dropped, and they began showing little progress—or no progress at all—in the performance of their assigned tasks. Boyle and Paasch generally attributed their lack of progress to their frustrations and to their "low morale"; they were dissatisfied with the results of the October 1970 desk audit, and with the "sluggish" investigation and disposition of their complaints and grievances. It appears that plaintiffs were spending a considerable amount of duty time on aspects of their grievances, and Boyle in fact testified that the drafting and redrafting of complaints interfered with his work. Plaintiffs also claim that certain personnel actions involving them—which they categorize as acts of harassment and reprisal—had an adverse impact upon their morale and upon their ability to carry out their work assignments. The first personnel action, in the spring of 1971, was the denial of Boyle's within-grade salary increase. The agency had determined that a step increase could not be justified in light of Boyle's inadequate progress on his assigned duties. Another personnel action which is claimed to have unfavorably influenced plaintiffs' morale was the institution of a six-month trial period of assignments at the GS–12 level. General Bratton, a Chief Supervisor of the Historical Division, advised plaintiffs, on March 2, 1971, as follows: "* * * to provide you with an additional opportunity to demonstrate your qualifications for promotion to the next higher grade I am directing the Chief, Historical Division, to give you a six-months trial period on an assignment wherein the work required, in quantity and quality, will be at the GS–12 level, although the degree of supervision and guidance given will be such as to keep the grade at the level of GS–11." Evidently, plaintiffs did not take General Bratton at his word, and they did not view this assignment as an opportunity for advancement; rather, they believed that the trial period at the GS-12 level was another act of harassment and reprisal.

Plaintiffs' work output did not improve to a level of acceptability. It was ultimately management's determination that Boyle and Paasch should be terminated for the good of the service. On July 13, 1971, Boyle received a Notice of Proposed Removal "for failure to perform assigned duties."[1] The notice, which was signed by General Bratton, reviewed and detailed the circumstances surrounding plaintiff's assignments and his performance (or lack thereof); it stated that plaintiff had failed to complete and submit assignments within the prescribed deadlines, and it alleged that Boyle was not applying himself to his work to the extent required of employees in his position. Plaintiff was advised that he had an opportunity to reply to the Notice of Proposed Removal by July 26, 1971, and that a final decision as to his termination would be made after that date. By memorandum of July 16, 1971, Boyle requested the General Counsel of the Department of Defense to declare the July 13th proposal null and void, and plaintiff notified General Bratton on July 26th that he would defer any response to the notice of removal until his appeal to the General Counsel was decided. General Bratton thereupon informed Boyle, on July 27, 1971, that a requested ruling from the General Counsel could not extend the July 26th deadline for reply; however, General Bratton stated that he would give consideration to any verbal or written reply presented by plaintiff before the close of business on July 29, 1971. Boyle did not respond by July 29th, or thereafter, and on August 6, 1971, he received a final notice removing him from his position, effective August 13, 1971.

On July 15, 1971, Paasch received her Notice of Proposed Removal "for failure to perform assigned duties." The letter, also signed by General Bratton, stated that she was not applying herself to her work, and that she had accordingly failed to complete and submit her assignments. It was noted that despite supervisory urgings and admonitions, Paasch had consistently reported, in recent months, no progress on her projects. Paasch responded to the notice on July 30, 1971. On August 11, 1971, she received final notice of removal, effective August 18, 1971.

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[1] Boyle had received a letter of proposed removal dated May 17, 1971, but that notice was cancelled.

Both of the plaintiffs appealed their removals to the Civil Service Commission. They requested that their appeals be heard simultaneously since the same issues, principles and materials were involved. A Hearing Examiner was assigned to both cases, and proceedings were conducted on November 18, 19 and 22, 1971. The reports of the Appeals Examining Office were issued on January 28, 1972, in which detailed findings of fact were made; it was recommended that the agency's decision to remove plaintiffs be sustained. The Appeals Examining Office grounded its recommendation as to Boyle's removal upon the following particular findings:

> An employee is expected to perform and accomplish a reasonable day's work on his assigned duties for each day's pay that he receives. It is clearly evident that Mr. Boyle, by his own admission, performed almost no work on his assigned duties from the beginning of January 1971 to July 13, 1971, the date of the advance notice, a period of about six (6) months.
>
> * * * * *
>
> Rather than pursue his dissatisfaction with management through the usual appellate and grievance channels, it appears that Mr. Boyle decided to embark upon a different course of action, i.e.,—not perform work, in order to focus attention on his dissatisfactions.
>
> From our review of the numerous and lengthy communications in file carrying Mr. Boyle's name as author or co-author, it appears that he was devoting all his efforts and energies towards focusing attention on his dissatisfactions rather than facing up to the responsibility of performing his assigned duties as a GS-11 Historian, for which he was being paid.

The Appeals Examining Office reached the same conclusions, in virtually identical language, in recommending that plaintiff Paasch's removal be sustained.

Plaintiffs appealed to the Civil Service Commission Board of Appeals and Review (BAR) on February 16, 1972; they assailed the action of the agency, and the decision of the

Appeals Examining Office, on various substantive and procedural grounds. The BAR concluded that the agency had satisfied all procedural requirements in processing the adverse actions; that the Appeals Examining Office properly found that the reason given for removal was supported by the evidence and sustained the charges; and that the removal action was not arbitrary, capricious or unreasonable, but was taken for such cause as would promote the efficiency of the service.

Boyle and Paasch subsequently filed suit in this court alleging that the decision to discharge them was arbitrary and capricious. Plaintiffs also contend that their removal was procedurally defective.

The standard by which we review personnel actions such as the one before us was stated in *Morelli* v. *United States*, 177 Ct. Cl. 848, 858 (1966), as follows:

> * * * Where an administrative agency has complied with the prescribed procedural requirements, the Court of Claims can only review the action to determine whether the officials who effected the dismissal acted arbitrarily, capriciously or were so grossly erroneous as to be in bad faith, as for instance where they may have acted without substantial evidence to support their decision or where they exceeded their authority.

*Accord*, *Ricci* v. *United States*, 205 Ct. Cl. 687, 693, 507 F. 2d 1390, 1393 (1974); *Grover* v. *United States*, 200 Ct. Cl. 337, 343 (1973); *Schlegel* v. *United States*, 189 Ct. Cl. 30, 36, 416 F. 2d 1372, 1375 (1969), *cert. denied*, 397 U.S. 1039 (1970). It is not our function to substitute our judgment for that of the employing agency or the Civil Service Commission; rather, we review the case to determine whether their action was reasonable in light of all the evidence. *Harrington* v. *United States*, 174 Ct. Cl. 1110, 1117 (1966); *Guiness* v. *United States*, 149 Ct. Cl. 1, 6, *cert. denied*, 363 U.S. 819 (1960). In testing the administrative action according to this standard of review, the presumption is that the Government officials have acted in good faith in making their decision. *Grover* v. *United States*, *supra; Travis* v. *United States*, 199 Ct. Cl. 67, 70 (1972); *Horne* v. *United States*, 190 Ct. Cl. 145, 150, 419 F. 2d 416, 419 (1969); *Morelli* v. *United States*, *supra; Greenway* v. *United States*, 175 Ct. Cl. 350, 362, *cert. denied*, 385 U.S. 881 (1966).

It is appropriate to observe at the outset that the prime duty and foremost obligation of any employee is to exert effort and energy in the accomplishment of assigned tasks. It is not too much to ask to require a person to function in the job he or she was hired to do. Those in the working force certainly have a legitimate interest in seeking to better their working conditions, and to that end an employee has a right to express his dissatisfactions to those in positions of higher authority. But he is assuredly not free to simply drop assigned work in order to protest management policies; nor is an employee permitted to devote all of his labor—at the expense of his normal duties—to convince superiors that his approach to management techniques is more enlightened than theirs. This court has admonished Government employees in the past that they may not refuse to do work merely because of disagreements with management, and that if they fail to perform their duties, they do so at the risk of being insubordinate. *See Burton* v. *United States*, 186 Ct. Cl. 172, 404 F. 2d 365 (1968), *cert. denied*, 394 U.S. 1002 (1969).

One of the inescapable conclusions which emerges from the record before us is that for a period of about six months Boyle and Paasch sat practically idle at their desks reporting very little progress in their work. Plaintiffs do not dispute their failure to perform assigned tasks; instead, they attempt to show that their lack of progress was justified. In our view, plaintiffs have failed to offer any satisfactory explanation to excuse their suspension of work. It is clear that these two junior historians did not have a good working relationship with their supervisors; plaintiffs evidently had very little faith in the supervisory abilities and management policies of the senior historians in their division. But dissatisfaction over management practices does not constitute a sufficient ground or reason to justify an employee's work-stoppage. Plaintiffs had the option to appeal the results of their desk audit, and they were also encouraged to formalize their grievances in accordance with Civil Service Commission procedures and regulations. They chose not to do so; instead, plaintiffs became embroiled in a controversy with their overseers, and they began reporting no progress in researching and writing their assignments, apparently in an effort to draw attention to their discontentment. Such inattention and neglect of designated duties would not be tolerated in the private sector; nor can it be sanctioned in Government employment, where there is arguably an even greater obligation owed by those in public service. Nor is "low morale"—which plaintiffs claim to have adversely affected their industry—a proper warrant for lack of diligence in performing assigned work. Somewhere along the line plaintiffs simply allowed their dissatisfaction to get the best of them, and they lost sight of the fact that their principal duty was to research and write history, which is the job they were hired to do.

Plaintiffs tell us that once they complained about the management of the Historical Division their supervisors began finding fault with their work. Plaintiffs charge their managers with the setting of arbitrary deadlines for the submission of their work; and they contend that their work was subject to unreasonable review and critique above and beyond the normal practice of the agency. Boyle and Paasch claim that these and other acts on the part of their superintendents were acts of harassment which, in effect, constituted reprisals for plaintiffs' complaints regarding the agency's working conditions and management practice. Plaintiffs contend that their overseers acted arbitrarily and maliciously towards them, and that the decision to remove them from their positions was rendered in bad faith. We do not consider the posture of plaintiffs' supervisors to have been malicious or hostile, and it is not our view that the personnel actions taken by them were acts of reprisal. The decision to more closely monitor Boyle's and Paasch's work was made only after plaintiffs failed to meet established deadlines and began to consistently report no progress on their assignments. The denial of Boyle's within-grade salary increase was completely justified in light of his failure to maintain an acceptable level of productivity. There is no evidence in the record to support the view that plaintiffs were given a trial assignment at the GS-12 level for reasons other than those stated by General Bratton, *viz.*, to enable them to prove themselves worthy of advancement. Contrary to plaintiffs' assertions, they were not discharged from their GS–11 positions for failure to prove their entitlement to promotion to grade GS–12. Plaintiffs have utterly failed to overcome the presumption that these Government officials acted in good faith in making their decisions.

After studying the briefs of the parties, listening to the arguments of counsel, and carefully considering the evidence in the record, we cannot say that the decision to remove plaintiffs "for failure to perform assigned duties" was arbitrary, capricious or unsupported by substantial evidence.

Plaintiffs contend that the administrative process was procedurally defective in two ways. It is first argued that plaintiff Boyle was not given an opportunity to reply to the July 31, 1971 Notice of Proposed Removal. Title 5 U.S.C. § 7501 (1970) provides that an employee whose removal is sought is entitled to "* * * reasonable time for filing a written answer to the charges * * *." The pertinent Civil Service Regulations, 5 C.F.R. 752.202(b) (1974) provide:

> * * * an employee is entitled to a reasonable time for answering a notice of proposed adverse action and for furnishing affidavits in support of his answer. The time to be allowed depends on the facts and circumstances of the case, and shall be sufficient to afford the employee ample opportunity to review the material relied on by the agency to support the reasons in the notice and to prepare an answer and secure affidavits * * *.

Boyle's letter of proposed removal, dated July 13, 1971, afforded him until July 26, 1971 to reply. Boyle asked the General Counsel of DOD to invalidate the notice of removal, and he informed General Bratton that he was postponing his response to the proposed removal until the General Counsel acted. General Bratton thereupon advised Boyle that an appeal to DOD's General Counsel could not serve to defer the July 26, 1971 deadline for answering, but that consideration would be given to any response submitted by the close of business on July 29, 1971. Boyle did not reply by July 29th, or thereafter, and on August 6, 1971, he received a final notice removing him from his position, effective August 13, 1971. In view of these circumstances, we are compelled to conclude that plaintiff was given ample time and reasonable opportunity to challenge his proposed removal.

Plaintiffs next assert that they were not given a fair hearing by the Appeals Examining Office. There is absolutely no merit to this contention; the record is devoid of any evidence to support the conclusion that plaintiffs were treated unfairly by the Hearing Examiner who conducted proceedings in this case. Plaintiffs say that the Hearing Examiner sustained their removal on grounds not charged by the agency. They specifically object to the Examiner's conclusion that they wilfully decided not to work in order to focus attention on their dissatisfactions. The letter of proposed removal sent to plaintiffs cited "failure to perform assigned duties" as the reason for the suggested adverse personnel action. Plaintiffs were specifically charged with not applying themselves to their work to the extent required of employees in their positions. The conclusion that Boyle and Paasch deliberately stopped working does not amount to the formulation by the Hearing Examiner of a new charge against plaintiffs; moreover, the Examiner's conclusion finds ample evidentiary support in the record.

Since the decision to remove plaintiffs was not arbitrary, capricious or unsupported by substantial evidence, and since the administrative proceedings were free of procedural defects, plaintiffs are not entitled to recover. Plaintiffs' motion for summary judgment is denied, and defendant's cross-motion for summary judgment is granted. The petitions are dismissed.

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517 F. 2d 938

# GRACE K. McFARLAND v. THE UNITED STATES

[No. 746-71. Decided May 14, 1975]

ON THE PROOFS

**Civilian pay; retirement for physical disability; right to hearing.**—Plaintiff seeks back pay, claiming that her involuntary retirement in June 1968 for physical disability from her civilian position with the Government was unlawful. Plaintiff contends that the agency application for her disability retirement and a psychiatric evaluation subsequent to said application, but prior to action by the Civil Service Commission on the application, constituted errors going to the heart of the administrative determination of disability, and that the Commission's refusal to grant her a hearing in connection with her efforts to obtain said reversal was arbitrary and erroneous. For the reasons set forth, it is *held* that there is no basis for setting aside the Commission's determination that plaintiff was totally disabled for useful and efficient service in her position. It is also *held* that an employee who was involuntarily retired for physical disability in June 1968 was not entitled to a hearing during the administrative proceedings. It is also *held* that since plaintiff was afforded a full hearing before the trial judge of this court wherein plaintiff testified, the requirement in *Arnett* v. *Kennedy*, 416 U.S. 134 (1974), of a hearing at "some time" has been met. Plaintiff is not entitled to recover and the petition is dismissed.

**Civilian pay; Civil Service retirement; disability retirement; disability determination of Commission; finality of.**

[1] The provision of the Retirement Act (5 U.S.C. § 8347(c)) to the effect that decisions of the Civil Service Commission concerning questions of disability are final and conclusive and not subject to review, imposes a special and unusual restriction on judicial examination, and courts can set aside such determinations only where there has been a substantial departure from important procedural rights, misconstruction of the governing legislation, or some like error going to the heart of the administrative determination.

**United States ⚷ 39(15)**

**Civilian pay; presumptions; official actions of Government officials; presumption of regularity.**

[2] In the absence of evidence to the contrary, the court will presume that officials responsible for the application for an employee's involuntary disability retirement acted in good faith.

**United States ⚷ 39(15)**

**Civilian pay; Civil Service retirement; disability retirement; involuntary disability retirement; authority of employing agency.**

[3] The agency decision to apply for plaintiff's disability retirement rather than to institute disciplinary action in consequence of certain incidents does not afford a basis for granting relief in plaintiff's suit for back pay on the ground that her involuntary disability retirement was unlawful.

**United States ⚷ 39(15)**

**Civilian pay; Civil Service retirement; disability retirement; disability determination of Commission; medical reports.**

[4] In view of the statutory restriction on judicial review of decisions of the Civil Service Commission concerning questions of employee disability, even repudiation of a medical evaluation adverse to the employee does not inexorably lead to the setting aside of the determination of the Commission. There is plainly no error going to

the heart of the administrative determination when the Commission accepts one medical view rather than another.

United States 🔑 39(15)

**Civilian pay; Civil Service retirement; disability retirement; hearing, right to.**

[5] The Civil Service Commission was not obligated under the regulations in force at the time here relevant, to grant a civilian employee a hearing in connection with an agency-instituted disability retirement proceeding, nor, even though that course might have been wiser or more advisable, was there any legal obligation to do so in connection with requests for reconsideration.

United States 🔑 39(15)

**Civilian pay; Civil Service retirement; disability retirement; hearing, right to; due process.**

[6] The range of interests protected by procedural due process is not infinite. The involuntary retirement of a civilian federal employee for physical disability, without prior hearing, is not a denial of the employee's constitutional rights. The due process requirement is met where a later court proceeding is allowed.

Constitutional Law 🔑 318(2)

*John J. Heise, Jr.*, attorney of record, for plaintiff. *Heise and Jorgensen*, of counsel.

*Raymond B. Benzinger*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before SKELTON, KASHIWA, and KUNZIG, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's exceptions to the recommended decision filed April 25, 1974, by Trial Judge Harry E. Wood pursuant to Rule 134(h). The court has considered the case on the briefs and oral argument of counsel. Since the court agrees with the trial judge's recommended decision, with modifications by the court, as hereinafter set forth,* it hereby affirms and adopts the same, as modified, as the basis for its judgment in this case.† Therefore, plaintiff is not entitled to recover and the petition is dismissed.**

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*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed April 25, 1974, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

†The concurring opinion of SKELTON, *Judge*, follows the opinion of the trial judge which has been adopted by the court.

**Plaintiff's request for rehearing and suggestion for rehearing *en banc* was denied June 27, 1975. Judge Skelton would grant *en banc* rehearing.

## OPINION OF TRIAL JUDGE

WOOD, *Trial Judge:* In this action, plaintiff sues to recover "back salary", less appropriate offsets, from and after June 12, 1968, on the ground that her involuntary retirement for physical disability from her position as an accounting technician, GS-5, at Patrick Air Force Base, Florida, effective June 11, 1968, was unlawful.

Plaintiff contends (1) that the agency application for plaintiff's disability retirement, and a psychiatric evaluation subsequent to the said application, but prior to action by the Civil Service Commission on the agency application, "constitute error which went to the very heart of the administrative determination of disability", and (2) that both the Civil Service Commission's "refusal to overturn its original determination" and its refusal to grant plaintiff a hearing in connection with her efforts to obtain reversal of the Commission's original determination, are arbitrary and erroneous.

Defendant urges that there is no basis for setting aside the Commission's determination that plaintiff was totally disabled for useful and efficient service in her position, and that, its defense of this action having been prejudiced by plaintiff's delay in commencing suit in this court, her claim is in any event barred by the doctrine of laches.

For reasons hereinafter set forth, and without reaching the question of laches, it is concluded that defendant's position on the merits is valid. Accordingly, plaintiff is not entitled to recover.

Plaintiff's employment at Patrick Air Force Base ("AFB") began in 1951. In 1958 she was separated by adverse action from her position as an accounting technician, GS-6, for inefficiency. On appeal, the separation was cancelled as procedurally defective, and she was restored to duty retroactively. Shortly thereafter, however, she was downgraded from GS-6 to GS-5 pursuant to a reduction-in-force.

Insofar as the present record shows, plaintiff's employment at Patrick AFB from 1958 to mid-1966 was not only satisfactory but seemingly not particularly eventful. The sole recorded incident concerning her during this period occurred in November 1964, when plaintiff's request for authorization to work overtime was denied by her then supervisor, Mr. Clark. She became upset and began to cry, and, according to the supervisor, created a scene.[1] It is clear from the record, however, that throughout her employment at Patrick AFB plaintiff felt she was being intimidated, persecuted, and subjected to "harassing pressures" by her superiors at Patrick AFB.

Early in 1966, responsibility for aviation fuels accounting, for some 4 years prior thereto a substantial part of plaintiff's duties as an accounting technician, GS-6, was transferred to another office. Plaintiff was not assigned any duties to replace those transferred, and her complaints about the loss of duties met with no success.

In June 1966, plaintiff's office (and plaintiff) came under the supervision of Mr. Lopez-Vega, theretofore a GS-9 at the Air Force Accounting and Finance Center. Plaintiff felt that she was qualified for, and should have been promoted to, the GS-7 supervisory position given to the new supervisor, and it is fair to conclude that she was resentful of both the appointment and the appointee.

Prior to his arrival at Patrick AFB, Mr. Lopez-Vega had been told by the Chief, Accounting and Finance Branch, Patrick AFB, that if he accepted the GS-7 position there he would be working with plaintiff, and that she would be very difficult to deal with. At Mr. Lopez-Vega's initial introduction to plaintiff, she made no response whatever to his greeting to her, and in his opinion the initial meeting was very unpleasant. Thereafter, whenever he had a problem or a conflict with her, he made a memorandum for the record describing the incident.

Between June 12, 1966 and September 12, 1966, Mr. Lopez-Vega recorded five incidents concerning plaintiff: in general terms, her failure or refusal to carry out his instructions on June 17, August 1, and August 12, 1966; her use of hostile and insulting language to a fellow worker on June 29, 1966; and, on September 8, 1966, her refusal to comply with his written instructions, coupled with her subsequent use of a vulgar word which created a very unpleasant situation in the office. There is no doubt that the several incidents just mentioned in fact occurred substantially as described.

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[1] Mr. Clark noted the incident on a Patrick AFB form used by supervisors for annotating some discussions with employees. Plaintiff went to higher authority with her request, and ultimately received the authorization she sought.

In October 1966, plaintiff was reprimanded for failure to carry out her assigned duties in a reasonable period of time on August 12, 1966, and for disorderly conduct on September 8, 1966. In the meantime, effective September 12, 1966 (after a downgrading as a result of a position survey to accounting technician, GS–5, with saved pay for 2 years), she had been transferred to another section, where she again came under the administrative supervision of Mr. Clark. From September 12, 1966 to February 2, 1967, there was no recorded incident of plaintiff's attitude or conduct in her new position.

On the morning of February 2, 1967, plaintiff and her technical supervisor, a Miss Grice, engaged in a rather emotional exchange over plaintiff's mailing, contrary to Miss Grice's instructions, of an original, rather than a duplicate, of a report. During the course of the exchange, Miss Grice slammed a posting ledger on the desk in front of plaintiff. Plaintiff went to Mr. Clark about the incident, stating that she was being blamed for everything and asking when she was going to get out of the section. During the discussion with Mr. Clark, plaintiff began to cry and became very upset. Mr. Clark made a record of the incident, and reported it to the Chief, Accounting and Finance Branch.

Shortly thereafter, "by reason of your disruptive job behavior which has continued over the past 3 years", the Chief, Accounting and Finance Branch, directed plaintiff to report to Patrick AFB Hospital for a medical examination to determine whether she was physically able to continue in her assigned tasks. The report of that examination, conducted February 20, 1967, by an Air Force medical officer, reflected that plaintiff's emotional and mental stability were poor, and contained a recommendation for "psychiatric workup for existing personality disorder."

By letter dated March 16, 1967, plaintiff was informed by the Chief, Accounting and Finance Branch, of an appointment March 23, 1967, with Dr. Edward J. Adickes, of Indialantic, Florida, near Patrick AFB. Plaintiff was advised that government transportation to Dr. Adickes' office had been arranged for her, and that if she refused to be examined or to have the results reported, she might be separated for that reason.

Dr. Adickes' March 24, 1967 report to the Civilian Personnel Office, Patrick AFB, of his psychiatric evaluation of plaintiff reflected the opinion that she evidenced marked difficulties in judgment when dealing with highly charged emotional material, and inappropriate and hostile attitudes. He concluded that plaintiff "has a persecution complex with paranoid delusions prominent enough to create difficulty in maintaining reasonable behavior." [2]

On April 6, 1967, Mr. Clark signed a Standard Form 2801–A, "Superior Officer's Statement In Connection With Application For Total Disability Retirement." Among other things, the said statement reflected that periodically plaintiff's "tantrums and emotional upsets disrupted the office." Under the heading of "instances of emotional instability or abnormal behavior", Mr. Clark listed the November 1964 incident involving plaintiff and Mr. Clark, each of the five June-September 1966 incidents described above, and the February 1967 incident involving plaintiff and Mr. Clark.

On April 19, 1967, plaintiff was afforded an opportunity to apply for disability retirement, but emphatically declined to do so. On April 20, 1967, an agency application for her disability retirement, accompanied by Standard Form 2801–A, the report of plaintiff's February 20, 1967, examination at Patrick AFB Hospital, Dr. Adickes' March 24, 1967, report, and a statement that plaintiff refused to execute an application for disability retirement were transmitted to the Atlanta Region, Civil Service Commission ("CSC").

At the request of the Regional Medical Officer, Atlanta Region, CSC, plaintiff was seen by Dr. James R. Parsons, of Melbourne, Florida, also near Patrick AFB, on May 25, 1967. Dr. Parsons had never seen plaintiff prior to that date, but he had received from Patrick AFB, and had read, a copy of Dr. Adickes' March 24, 1967, report concerning her.

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[2] Dr. Adickes died well prior to trial of this cause.

Dr. Parsons' understanding in 1967 was that only one appointment for plaintiff with him in connection with his evaluation of her was possible.

By letter dated June 15, 1967, to the Regional Medical Officer, Atlanta Region, CSC, Dr. Parsons reported plaintiff's sudden loss of courtesy and composure within less than 5 minutes, and her demonstration of "a very marked 'push of speech' * * * interrupted by flashes of intense hostility in her eyes, followed by inappropriate smiling, when tears would well up and almost overflow." He felt that on some level of consciousness plaintiff knew she was very ill, stated that he hoped she would be able to receive treatment, and made a diagnosis of "Schizophrenic Reaction, Paranoid Type, With Depressive Trend."

In due course the agency application and supporting documentation reached the Bureau of Retirement and Insurance, CSC, Washington, D.C., and on July 20, 1967, plaintiff was notified that it had been determined that she should be retired for disability, and was advised of her right of appeal.

In August 1967, plaintiff transmitted to the Bureau of Retirement and Insurance the opinion of Dr. William H. Geiger, a private psychiatrist who had examined her August 10, 1967. Dr. Geiger's impression was, in substance, that plaintiff was intelligent, with no evidence of organic brain damage or major mental illness. Treating plaintiff's correspondence as an appeal, the Medical Division, CSC, forwarded the matter to the Board of Appeals and Review ("BAR"). By decision dated October 31, 1967, the BAR, after referring to the medical evidence in the record, including Dr. Geiger's opinion, upheld the determination of the Bureau of Retirement and Insurance. In consequence, plaintiff's disability retirement became effective June 11, 1968.

Thereafter, plaintiff (and others on her behalf) began an extensive series of correspondence with the Commission, as detailed in the findings. Among other things, plaintiff sought, obtained, and submitted to the Commission from time to time, reports from psychiatrists and psychologists who had examined her, and in January 1969, she requested, as she had prior thereto, that she be afforded a hearing.

The 1969 request for hearing followed a second visit, on September 23, 1968, to Dr. Parsons. During this visit, lasting approximately 45 minutes, plaintiff presented to Dr. Parsons letters she had obtained from Dr. Geiger and other doctors following May 1967.

By letter dated September 24, 1968, to the Commission, Dr. Parsons stated that he felt that his earlier impression of plaintiff was "not consistent with her present appearance, as well as the fact that she has been able to impress other psychiatrists favorably", and that following plaintiff's 1967 appointment with him he had instructed his secretary to refuse further "single-visit-evaluations" since such evaluations were "not fair to either patient or pschiatrist." Dr. Parsons concluded that:

> In retrospect, I feel that [plaintiff] was under a strain of presenting a tremendous amount of information to me in a very limited time, so that she appeared much more disorganized than she actually is. Again, that single interview was not entirely equitable; I see no reason why [plaintiff's] appeal should not be considered favorably.

Then and on several occasions thereafter, however, the Commission has consistently adhered to its determination that allowance of the agency's application for plaintiff's disability retirement was warranted. Nor was plaintiff ever afforded a hearing by the Commission.

In the 1966 codification of Title 5, United States Code, Congress provided that any federal employee "who completes 5 years of civilian service and is found by the Civil Service Commission to have become disabled shall be retired on his own application or on application by his agency", that the Commission should "determine questions of disability and dependency arising under this subchapter", and that "The decisions of the Commission concerning these matters are final and conclusive and not subject to review." 5 U.S.C. §§ 8337, 8347(c) (1970).

In *Scroggins* v. *United States*, 184 Ct. Cl. 530, 533–34, 397 F. 2d 295, 297, *cert. denied*, 393 U.S. 952 (1968), this court held that the latter provision

> * * * is a special and unusual restriction on judicial examination, and under it courts are not as free to

> review Commission retirement decisions as they would be if the "finality" clause were not there. * * * at best, a court can set aside the Commission's determination "only where there has been a substantial departure from important procedural rights, a misconstruction of the governing legislation, or some like error 'going to the heart of the administrative determination.' " *Gaines* v. *United States*, 158 Ct. Cl. 497, 502, *cert. denied*, 371 U.S. 936 (1962). * * *

See also *Lech* v. *United States*, 187 Ct. Cl. 471, 409 F. 2d 252 (1969); *McGlasson* v. *United States*, 184 Ct. Cl. 542, 397 F. 2d 303 (1968); *Kleinfelter* v. *United States*, 162 Ct. Cl. 88, 318 F. 2d 929 (1963).

One of plaintiff's arguments is that the actions of officials at Patrick AFB in preparing an application for disability retirement constituted vitiating error. Focusing upon the Standard Form 2801-A prepared concerning plaintiff, she vigorously urges that Patrick AFB officials overzealously magnified "isolated confrontations between plaintiff and her supervisors * * * out of all proportion * * *", that she was neither emotionally unstable nor a disruptive influence in her office, and that "The events do not support the conclusion which the Agency drew."

The presumption that government officials have acted in good faith in making a decision can be overcome only by a strong showing to the contrary. *Roski* v. *United States*, 204 Ct. Cl. 40 (1974); *Grover* v. *United States*, 200 Ct. Cl. 337, 343–44 (1973). There is no room for doubt that the incidents listed by Mr. Clark in the Standard Form 2801-A occurred, nor is there any persuasive proof in this record of distortion, magnification, or improper motivation by any agency official in connection with Standard Form 2801-A. While there is room for doubt that agency action in preparing the application is of any relevance here, it is in any event clear that the presumption of good faith has not been overcome. *Lech* v. *United States*, *supra; McGlasson* v. *United States*, *supra.*

Moreover, the incidents listed in the Standard Form 2801-A were not the sole basis for the agency's April 20, 1967, decision to apply for plaintiff's involuntary retirement for physical disability, as plaintiff seems to suggest. That decision followed, and rested in large part upon, a February 20, 1967, report of medical examination at Patrick AFB Hospital, stating that plaintiff needed a psychiatric workup for an existing mental disorder, and Dr. Adickes' March 24, 1967, psychiatric report, stating that plaintiff had a persecution complex with prominent paranoid delusions.

If, as plaintiff asserts, she might properly have been subjected to disciplinary action in consequence of the incidents listed in Standard Form 2801–A, the actual agency decision in April 1967 to apply for plaintiff's involuntary retirement plainly affords no basis for granting any relief here. *Scroggins* v. *United States*, *supra; McGlasson* v. *United States*, *supra; Gaines* v. *United States*, 158 Ct. Cl. 497, *cert. denied*, 371 U.S. 936 (1962).

Plaintiff also contends that Dr. Parsons' original evaluation of plaintiff, in May 1967, was unfair, improper, and inaccurate, that "once Dr. Parsons determined that his evaluation of plaintiff was inaccurate and improper, then there was an error which went to the very heart of the administrative determination", and that when Dr. Parsons "repudiated his position and announced that he was wrong, the refusal [of the Commission] to overturn its original determination was arbitrary."

Dr. Parsons' September 1968 report to the Commission concerning plaintiff was made, as was his June 1967 report, after seeing her for about 45 minutes. His only other contact with plaintiff between the two reports was very brief. On careful reading, Dr. Parsons' September 1968 report reflected clearly his opinion that a "single-visit-evaluation" was inherently unfair, and that plaintiff's "present appearance" was not consistent with his earlier impression of her, but the argument that he "repudiated his position and announced that he was wrong", then or in later presentations to the Commission, is not entirely accurate. That aside, however, plaintiff's position is not a tenable one.

The duty of determining questions of disability is imposed by statute on the Commission, and only some error "going to the heart of the administrative determination", as defined in *Scroggins* v. *United States*, *supra*, permits the setting aside by a court of the administrative discharge of that duty. Even repudiation of a medical evaluation adverse to an employee would not inexorably lead to such action. *Cf. Roski* v. *United States, supra.*

Dr. Adickes' psychiatric evaluation of plaintiff, which he refused to reconsider, was adverse to her. Dr. Parsons did reconsider, and at least at trial, he did testify that his first opinion was definitely inaccurate. In any event, the Commission had before it a mass of medical evidence, as detailed in the findings, concerning plaintiff. In March 1971, and again on April 1, 1971, the Commission reviewed all of the medical evidence before it. On both occasions it concluded that reopening its previous decision was unwarranted. "There is plainly no error going to the 'heart of the administrative determination' when the Commission accepts one medical view rather than another." *Scroggins* v. *United States, supra,* 184 Ct. Cl. at 537, 397 F. 2d at 300; see also *McGlasson* v. *United States, supra; Gaines* v. *United States, supra; cf. Roski* v. *United States, supra.*

In her main brief, filed herein April 9, 1973, plaintiff conceded that she was not entitled, under Commission regulations, to a hearing "in the first instance", but asserted that the Commission's failure to grant her request for a hearing after Dr. Parsons' 1968 letter to the Commission was arbitrary.

Putting considerations of due process aside for the moment, the Commission was under no legal obligation to grant plaintiff a hearing in connection with the application for her retirement, nor, "even though that course might have been wiser or more advisable", was it under any legal obligation to do so in connection with her repeated requests for reconsideration. *Scroggins* v. *United States, supra,* 184 Ct. Cl. at 535, 397 F. 2d at 298. Indeed, plaintiff's argument in this connection is, on analysis, really no more than that the circumstances warranted a hearing, and that the Commission had authority to hold one.

In plaintiff's reply brief, however, a right to a "due process hearing *before* the termination of her rights as a Civil Service employee and her discharge from public employment" is asserted. For this proposition, plaintiff cites *Board of Regents* v. *Roth,* 408 U.S. 564 (1972); *Morrissey* v. *Brewer,* 408 U.S. 471 (1972); *Goldberg* v. *Kelly,* 397 U.S. 254 (1970); and

*Kennedy* v. *Sanchez*, 349 F. Supp. 863 (N.D. Ill. 1972), *prob. juris. noted sub nom.*, *Phillips* v. *Kennedy*, 411 U.S. 915 (1973) (*rev'd sub nom.*, *Arnett* v. *Kennedy*, 416 U.S. 134 (1974).[3] While this claim of constitutional right is plainly inconsistent with plaintiff's earlier concession, it is nonetheless now to be considered. See *Scroggins* v. *United States*, *supra*, 184 Ct. Cl. at 534, n. 4, 397 F. 2d at 298, n. 4; *cf. Roski* v. *United States*, *supra; Haynes* v. *United States*, 190 Ct. Cl. 9, 418 F. 2d 1380 (1969).

It is clear that the range of interests protected by procedural due process is not infinite. *Board of Regents* v. *Roth*, *supra*, 408 U.S. at 570; *cf. Sampson* v. *Murray*, 415 U.S. 61 (1974). And, in light of *Arnett* v. *Kennedy*, *supra*, it is equally clear that plaintiff's claim of constitutional right to a hearing prior to her disability retirement is invalid.

While plaintiff has not urged a constitutional right to a due process hearing following her disability retirement, the several opinions in *Arnett* v. *Kennedy*, *supra*, strongly suggest that this aspect of the matter too should be considered and decided.

In *Scroggins* v. *United States*, *supra*, plaintiff asserted both a statutory and a constitutional right to a "trial-type hearing (or the prime elements of one) * * *" in connection with her involuntary retirement for disability. The court, observing that it and other courts had "already declared otherwise", saw "no adequate reason to depart at this time from that unanimous position."

Neither *Arnett* v. *Kennedy*, *supra*, nor any of the cases cited in plaintiff's reply brief, involved the disability retirement of a federal employee.[4] As late as December 1973, the court held that the involuntary retirement for physical disability, without prior hearing, of a hearing examiner was invalid on statutory, not constitutional, grounds. *Benton* v.

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[3] Plaintiff's Reply Brief was filed herein November 15, 1973, some months prior to the decision in *Arnett* v. *Kennedy, supra.*

[4] Justice White in *Arnett* v. *Kennedy, supra,* states at page 186:

"A different case might be put, of course, if the termination were for reasons of pure inefficiency, assuming such a general reason could be given, in which case it would be at least arguable that a hearing would serve no useful purpose and that judgments of this kind are best left to the discretion of administrative officials. This is not such a case, however, since Kennedy was terminated on specific charges of misconduct."

*United States*, 203 Ct. Cl. 263, 488 F. 2d 1017 (1973). In light of the nature of this case, the decisions of this court in *Scroggins* and *Benton*, and the absence of any authority contradicting the "unanimous position" taken by this and other courts on this issue, no denial of plaintiff's constitutional rights can be perceived.

Furthermore, in *Arnett* v. *Kennedy*, *supra*, at 178–179, with relation to the requirement of a hearing at "some time," Justice White stated as follows:

> * * * Where the Court has rejected the need for a hearing prior to the initial "taking," a principal rationale has been that a hearing would be provided before the taking became final. See *North American Cold Storage Co.* v. *Chicago*, 211 U.S. 306 (1908) (seizure of food unfit for consumption); *Central Trust Co.* v. *Garvan*, 254 U.S. 554 (1921) (seizure of property under Trading with the Enemy Act); *Corn Exchange Bank* v. *Coler*, 280 U.S. 218 (1930) (seizure of assets of an absconding husband); *Phillips* v. *Commissioner*, 283 U.S. 589 (1931) (collection of a tax); *Bowles* v. *Willingham*, 321 U.S. 503 (1944) (setting of price regulations); *Fahey* v. *Mallonee*, 332 U.S. 245 (1947) (appointment of conservator of assets of savings and loan association); *Ewing* v. *Mytinger & Casselberry*, 339 U.S. 594 (1950) (seizure of misbranded articles in commerce). While these cases indicate that the particular interests involved might not have demanded a hearing immediately, they also reaffirm the principle that property may not be taken without a hearing at some time.

In *Phillips* v. *Commissioner*, *supra*, a tax case, the hearings mentioned in the case include hearings in courts; in *Central Trust Co.* v. *Garvan*, *supra*, a trading with the enemy case, the hearing referred to is also that in the courts after the taking. An examination of the other cases cited indicates that they contemplate a later court review. In other words, the due process requirement is met where a later court proceeding is allowed. In the present case, plaintiff was afforded a full hearing before the trial judge of this court. The hearing lasted two days. The transcript of testimony covers 436 pages, and 13 witnesses were heard with full right of cross examination given plaintiff. Plaintiff herself testified. Plaintiff's complaint that there was no hearing is certainly satisfied by the hearing afforded before the trial judge. The requirement in *Arnett* v. *Kennedy* of a hearing at "some time" is clearly met.

See, also, *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 149 (1974), where the Court stated:

> * * * Further, with the Tucker Act remedy, the payment of "fair and equitable consideration" in compliance with the reorganization statutes is assured, and procedural due process is satisfied.

Accordingly, and without reaching the possible impact of the doctrine of laches on plaintiff's claim, it is concluded that she is not entitled to recover, and that the petition should be dismissed.

SKELTON, *Judge*, concurring:

I concur in the decision of the court for the sole reason that under our rules our panel cannot overrule the *en banc* decision of the court in *Scroggins* v. *United States*, 184 Ct. Cl. 530, 397 F. 2d 295, *cert. denied*, 393 U.S. 952 (1968) in which the court held that in an involuntary retirement case where physical disability is the basis for the retirement, the retired employee is not entitled to a hearing at any stage of the proceedings.

Were it not for our rule aforesaid, I would dissent on the ground that the plaintiff was entitled to a hearing before her involuntary retirement became final because of the later decision of the Supreme Court in *Arnett* v. *Kennedy*, 416 U.S. 134 (1974), and other similar cases. In that case the Supreme Court held that a government job was property that could not be taken away from an employee without a hearing at some stage of the proceedings because of the due process clause of the Constitution. While it is true that case involved the discharge of an employee for cause and not retirement for disability, I think the same basic rules should apply and that a hearing is required by the due process clause in both instances. See also the following decisions of the Supreme Court in which the Court held that where property is taken from a citizen the due process clause requires a hearing: *Connell* v. *Higginbotham*, 403 U.S. 207 (1971) (loss of a state job); *Goldberg* v. *Kelly*, 397 U.S. 254 (1970) (loss of welfare payments); *Morrissey* v. *Brewer*, 408 U.S. 471

(1972) (revocation of a parole); *Wolff v. McDonnell*, 418 U.S. 539 (1974) (cancellation of a prisoner's good-time credits); *Bell* v. *Burson*, 402 U.S. 535 (1971) (cancellation of a driver's license); *Board of Regents* v. *Roth*, 408 U.S. 564 (1972) (damaged reputation and standing); *Sniadach* v. *Family Finance Corp.*, 395 U.S. 337 (1969) (garnishment of wages); *Fuentes* v. *Shevin*, 407 U.S. 67 (1972) (seizure of mortgaged property); and *Goss* v. *Lopez*, 419 U.S. 565 (1975) (suspension of school children).

### CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover and the petition is dismissed.

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515 F. 2d 1404

## THE UNITED STATES v. PUEBLO OF TAOS

Appeal No. 14–74

Ind. Cl. Comm. Docket No. 357–A

33 Ind. Cl. Comm. 82

[Decided May 14, 1975]

### ON APPEAL FROM THE INDIAN CLAIMS COMMISSION

**Indian claims; appeal from Indian Claims Commission; Pueblo Lands Board; extinguishment of Indian title; interest on award.**—The United States in prosecuting this appeal from an interlocutory order, opinion and findings of the Indian Claims Commission concedes it is liable to the Pueblo of Taos in the sum of $297,684.67 on account of extinguishment of its title to 926 acres in the town of Taos, but denies liability for payment of simple interest thereon. The Commission held that there had been a Fifth Amendment taking entitling the Indians to simple interest at 5% on said sum from March 17, 1927 until paid, less allowable offsets. The Pueblo Lands Board, based on the mistaken assumption that a Spanish grant to another grantee overlapped the grant to the Indians in the townsite area and because the Indians ceased the prosecution of their claims in the erroneous belief that the Board could and would allow them their Blue Lake Canyon claim as an offset, determined that the United

States was not liable to the Indians for the townsite land. Appellant contends that the creation of the Board was a good faith effort by Congress to do justice to the Indians and therefore the standards for an act of trusteeship rather than a Fifth Amendment taking are satisfied. The court *affirms* that this was a Fifth Amendment taking entitling the Indians to just compensation, including interest. It is also *held* that since the Board knew that the Pueblo Indians were under full Government wardship it should have taken appropriate precautions to protect their interests and since the decision of the Board was partly based on the erroneous belief that the Indians had waived their claim, no error appears in the record because the Commission did not bar the claim on the ground of collateral estoppel or res judicata. The court *affirms* the Commission's selection of the 1924 date for interest to start running and its refusal of interest on delay in payment of sums awarded by the Board for lands outside the townsite area. The order of the Commission is affirmed and the case is remanded to the Commission for further proceedings to complete its disposition of the case.

**Indian claims; land; title to land; extinguishment of Indian title; trustee v. taker of Indian property.**

[1] Enactment of Pub. L. 91-550 in order to safeguard the interests and welfare of the Pueblo of Taos Indians and awarding them the Blue Lake area, subject to certain conservation restrictions, cannot retroactively reconvert to an exercise of trusteeship the acts of the Public Lands Board determining, *inter alia*, that the United States was not liable to the Indians for the town of Taos lands.

Indians 🔑 10

**Indian claims; taking of Indian property; erroneous survey; interest on awards.**

[2] Deprivation of an Indian tribe of its property in land, by an error of the United States as to the location of a boundary or the devolution of a title, constitutes a Fifth Amendment taking if the property is then turned over to another owner. Such takings typically generate awards including interest as part of just compensation, even where defendant relied on the good faith of an error in a survey to avoid taking liability.

Eminent Domain 🔑 2(1), 148

**Pleading and practice; defenses; collateral estoppel; failure to plead.**

[3] Collateral estoppel is an affirmative defense that normally belongs to the party relying on it who must give notice of his intention to do so.

Judgment 🔑 948(1)

**Indian claims; judgments; former adjudication; res judicata/collateral estoppel.**

[4] The bar of res judicata and collateral estoppel is not absolute against Indian tribes, any more than other litigants. It can be lifted by an "independent action" in another tribunal if the original

**decision alleged as a bar was unconscionable because obtained by fraud on the court, or for various other reasons in the same family. The tribunal to entertain the "independent action" is one that would have jurisdiction apart from the res judicata bar. In a case of collateral estoppel, the lack of a full and fair opportunity to litigate would prevent it from applying.**

**United States 🔑 113**

**Indian claims; fiduciary obligation of Government to Indians; Pueblo Lands Board.**

**[5] Since the creation of the Pueblo Lands Board and reinstatement of Federal laws inhibiting non-Indians from acquiring Indian land were occasioned by the Supreme Court pronouncement in *United States* v. *Sandoval*, 231 U.S. 28 (1913), that the Pueblo Indians were under full Government tutelage, being a simple, uninformed and inferior people, the Pueblo Lands Board was in error in accepting waiver, compromise or abandonment of a claim by the Pueblo Indians without taking precautions appropriate in case of claimants under guardianship or wardship, such as whether the Indians had been given fair and unbiased advice by their counsel as to the merits of a proposed compromise, whether adequate means were taken to inform them of the proposal and whether they voted for it in their elections.**

**United States 🔑 113**

**Indian claims; judgments; former adjudication; res judicata/ collateral estoppel.**

**[6] Where the Pueblo Lands Board failed to take appropriate safeguards to protect the land interests of the Pueblo Indians as wards of the Government, erroneously believed that the Indians had waived their claim, and mistakenly determined that the Indians did not have valid claim to the town of Taos land, the Indian Claims Commission was not in error in not barring the Indians' claim on the ground of collateral estoppel or res judicata.**

**United States 🔑 113**

*A. Donald Mileur*, with whom was *Assistant Attorney General Wallace H. Johnson*, for appellant. *Roberta A. Swartzendruber*, attorney of record.

*Richard Schifter*, for appellees. *Darwin P. Kingsley, Jr.*, attorney of record. *Karelsen & Karelsen; S. Bobo Dean, Jay R. Kraemer, Fried, Frank, Harris, Shriver & Kampelman*, of counsel.

Before NICHOLS, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: We have before us for review, an interlocutory order, opinion, and findings of the Indian Claims Commission, reported 33 Ind. Cl. Comm. 82 and ff. (1974). The United States, in prosecuting its appeal here, concedes it is liable to pay the appellee Pueblo of Taos the sum of $297,684.67 on account of extinguishment of appellee's title to 926 acres constituting or including the town of Taos, New Mexico. It denies it is liable, as the Commission has held, to pay simple interest on that sum, at 5% per annum from March 17, 1927, until paid. Said payment, with or without interest, will be subject to offsets as set forth in the order.

The Commission, citing decisions of this court, states the interest issue to turn on whether the United States in extinguishing the Indians' title, acted as guardian or trustee over Indian property, or as a taker obliged by the Fifth Amendment to pay just compensation. It continues, if a taking is sought to be predicated on disposition of Indian property to third parties, the criterion is whether Congress in disposing of the property has made a good faith effort to realize its full value for the Indians. *Three Affiliated Tribes of The Fort Berthold Reservation* v. *United States*, 182 Ct. Cl. 543, 557, 390 F. 2d 686 (1968).

It is unnecessary to trace the history of the Indians' title and the complex operations by which it was extinguished without compensation. This is sufficiently done in the Commission's exhaustive opinion, which we incorporate by reference but need not repeat since only the interest is now in dispute. The Congress may have intended that the Pueblo Lands Board established as its instrument under the Pueblo Lands Act, 43 Stat. 636, should extinguish Indian title only in accord with trusteeship standards. The Board failed to do so because of its unfortunate mistaken assumption that a Spanish grant to another grantee overlapped the grant to the Indians in the townsite area, and because the Indians ceased the prosecution of their claims in the erroneous belief that the Board could and would allow them their Blue Lake Canyon claim as an offset. The Congress repeatedly had the unsatisfactory nature of the Board's work called to its attention and failed to take appropriate action, until in 1970 it enacted Pub. L. 91-550, 91st Cong. 2d Sess. (84 Stat. 1437), awarding 48,000 acres of the Blue Lake area to the

Indians, subject to certain conservation restrictions. This will serve as an offset, as the statute requires, but cannot retroactively reconvert the acts of the Pueblo Lands Board to an exercise of trusteeship, and is not intended to.

Appellant United States says that the creation of the Pueblo Lands Board was a good faith effort by Congress to do justice, and therefor the standards for an act of trusteeship, rather than a taking, are satisfied. The above cited "good faith effort" decision, *Three Affiliated Tribes of The Fort Berthold Reservation*, was not intended to overrule earlier Supreme Court decisions, nor could it have done so, but to synthesize the various rules laid down in them. The Supreme Court has repeatedly held that the deprivation of an Indian tribe of its property in land, by an error of the United States as to the location of a boundary or the devolution of a title, constitutes a Fifth Amendment taking if the property is then turned over to another owner. *United States* v. *Creek Nation*, 295 U.S. 103 (1935); *Chippewa Indians* v. *United States*, 301 U.S. 358, 375 (1937). Such takings typically generate awards including interest as part of just compensation, *United States* v. *Creek Nation*, *supra; Shoshone Tribe* v. *United States*, 299 U.S. 476 (1937). This has been followed where defendant relied on the good faith of an error in a survey to avoid taking liability. *Sioux Tribe of Indians* v. *United States*, 161 Ct. Cl. 413, 315 F. 2d 378, *cert. denied*, 375 U.S. 825 (1963). It is to be presumed that whatever effort the United States made in the above cases to decide correctly was not sufficient in the circumstances. It was also insufficient here. The "good faith effort" doctrine appears to have a more significant role with respect to land value issues, which are matters of opinion anyway, than it does with respect to determinations as to land titles and boundaries, which are either right or wrong, absolutely. Appellant no longer contends that the Pueblo Land Board decision was right.

Appellant decided to drop the defense that the claimant Indians were barred by collateral estoppel, the Commission having considered it and ruled adversely on it in the decision under review. Such a defense normally belongs to the party relying on it, who must give notice of his intention to do so.

*Blonder-Tongue Labs Inc.* v. *University Foundation*, 402 U.S. 313, 350 (1971). This court inquired at oral argument for what reasons the defense was not pressed, and the ensuing colloquy led to an agreement that both parties would submit supplemental briefs, which they have done. Appellant says the defense, if available, would be collateral estoppel, not *res judicata*, and admits in the circumstances appellant can benefit from it now only if we perceive "plain error" in the decision below.

The short answer is that even disregarding appellant's position changes from time to time, we do not see "plain error". Our decision in *Andrade* v. *United States*, 202 Ct. Cl. 988, 485 F. 2d 660 (1973), *cert. denied*, 419 U.S. 831 (1974), reflects that the bar of *res judicata* and collateral estoppel is not absolute against Indian tribes, any more than other litigants. It can be lifted by an "independent action" in another tribunal if the original decision alleged as a bar was unconscionable because obtained by fraud on the court, or for various other reasons in the same family. The tribunal to entertain the "independent action" is one that would have jurisdiction apart from the *res judicata* bar. In a case of collateral estoppel, the lack of a full and fair opportunity to litigate would prevent it from applying. *Blonder-Tongue*, *supra*. The Indian Claims Commission proceeding here under review is the "independent action" before us.

The Pueblo Lands Board knew on the authority of the United States Supreme Court that the Pueblo Indians were under full Government tutelage, true

> * * * Indians in race, customs, and domestic government. Always living in separate and isolated communities, adhering to primitive modes of life, largely influenced by superstition and fetichism, and chiefly governed according to the crude customs inherited from their ancestors, they are essentially a simple, uninformed and inferior people. * * * (*United States* v. *Sandoval*, 231 U.S. 28, 39 (1913)).

It was this decision, restoring the Pueblo lands to status as "Indian Country", and reinstating the Federal laws that inhibited non-Indians from acquiring Indian land, that was the occasion for creation of the Pueblo Lands Board. The Board, therefore, should not have accepted any waiver, compromise, or abandonment of a claim by Pueblo Indians, without taking the precautions that are appropriate in case of a claimant under guardianship or wardship.

What these precautions are appear in *Andrade, supra.* Indeed, the reported proceedings of the Indian Claims Commission, there reviewed, were a model of what such precautions ought to be. They inquired whether the Indians had been given fair and unbiased advice by their counsel as to the merits of the proposed compromise, whether adequate means were taken to inform them of the proposal, and whether they voted for it in fair elections.

No such precautions were taken by the Pueblo Lands Board. A majority of the Taos Pueblo Council appeared before the Board, unaccompanied by the Counsel who represented them in that tribunal. The Governor of the Pueblo stated the Pueblo intended to waive their claim for the townsite. The Board learned then or soon thereafter that they expected a *quid pro quo* in the Blue Lake Canyon. The Board was urged either to reopen the hearings and determine the rights of the claimants, or else do something to effectuate the exchange. They determined that the latter was beyond their charter, yet did nothing along the former line.

In these circumstances, we do not have to hold whether the claim is barred by collateral estoppel or *res judicata.* We only have to determine whether "plain error" appears in the record because the Commission did not bar it on one or the other ground. It does not appear, because the Board determination, on the record made, could have been and probably was tainted by not giving such full and fair opportunity to litigate, as was appropriate for a litigant under Government wardship.

The Commission says the Board decision is *res judicata* on the issue before it, namely, whether the United States could have recovered the Town of Taos by seasonable prosecution within the meaning of Section 6 of the Pueblo Lands Act. It is not *res judicata*, says the Commission, as to whether the United States took the Town without just compensation under the Fifth Amendment. The appellant now says there is only a semantic difference between these issues, the answer to the one leading inevitably to the answer to the other. One reason why the Board thought the United States could not have recovered the townsite for the Indians is that it thought—erroneously as we now know—that the Indians had no valid claim to it. The basis of the Commission's holding of course is that they did have a good claim. To the extent the Board's decision was based on the idea that the Indians had waived their claim, we find this ground of avoiding *res judicata* meshes in with the one we suggest above and adds little to it. We meet ourselves coming back.

The Commission's views of the claim are not the only ones possible for a reasonable mind to take, but appellant has failed to show the case is within any of the categories of error that would warrant reversal under the statute, 25 U.S.C. § 70s.

In their cross-appeal, the Indians would have the interest start running in 1924, not 1927. We think the Commission's selection of the later date is within its powers. The Commission also refused interest on delay in payment of sums awarded by the Pueblo Lands Board for lands outside the townsite. We see no error in this.

Accordingly the order of the Indian Claims Commission, appealed here, is affirmed, and the case is remanded to the Commission for further proceedings to complete its disposition of the case.

*Affirmed*

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515 F. 2d 1383

## ROBERT C. BRAY v. THE UNITED STATES

[No. 182-68. Decided May 14, 1975]

### OPINION

**Military pay; discharge; Air Force discharge processing where homosexual acts or tendencies are involved; procedural violations; de novo evidence.**—Plaintiff, a former staff sergeant in the Air Force, on July 3, 1962 was discharged involuntarily for unfitness as a Class II homosexual prior to expiration of his current term of enlistment, the type of discharge precluding reenlistment. At the time of discharge plaintiff had served 17 years, 2 months and 21 days of active service in various foreign countries. His 20 years of active service for retirement eligibility would have ended on or about April 13, 1965. Plaintiff denies the homosexual charge, contests the validity of his discharge, and seeks judgment for active duty pay and allowances as a staff sergeant from July 3, 1962 to April 30, 1965, for retired pay of a staff sergeant computed on the basis of 20 years of active service from May 1, 1965, and for correction of his military records to reflect reinstatement, reenlistment and retirement. In November 1961 the Office of Special Investigation (OSI) at Eielson AFB in Alaska commenced an investigation of plaintiff for alleged homosexual activities, the investigation leading to institution of proceedings under provisions of AFR 35-66 and eventual discharge. The allegations against plaintiff were considered at two proceedings of a board of officers, convened pursuant to AFR 35-66. Plaintiff's appeals of his discharge to the Air Force Board for Correction of Military Records were denied without hearing. It is *held* (1) that the reception of de novo evidence in this case was appropriate. For the reasons set forth in the opinion, it is also *held* (2) that the Air Force discharge processing procedures respecting plaintiff do not satisfy the requirements of applicable regulations and invalidated plaintiff's discharge. The Commander (discharge authority) in disapproving the first board's findings and recommendations and directing appointment of a new board without reasons for such disapproval contravened the provisions of para. 21b(7) of AFR 35-66. Also, the failure to have available an essential witness who was permitted to leave the area on rotation violated para. 8 of AFR 35-66. Furthermore, the OSI summary (purportedly summarizing four OSI reports not in evidence before the court), incorporates a digest of the testimony of the discredited witness and the disputed writing and was available for use in each of the board and the correction board proceedings. The digest has been continuously renewed at each stage of plaintiff's efforts to defend himself; this information is prejudicial and should have been excluded. It is also *held* (3) that plaintiff is entitled to recover active duty pay and allowances for the period from his invalid discharge to the end of his then enlistment term, March 13, 1964; that plaintiff has no reenlistment rights; and that on final order an appropriate remand will be entered directing the Secretary of the Air Force to expunge all documents relative to plaintiff's invalid discharge and to correct his official military records.

**Military pay; trial de novo; Court of Claims, jurisdiction to hold.**

[1] The Court of Claims may hold a trial de novo on the merits of a claim which has been heard previously by a military board in order that plaintiff may have a judicial determination of the disputed factual issues involved in his claim. The court need not limit its review to the administrative record as in the case in Wunderlich Act contract disputes where plaintiff contracts away such right.

Courts 🔑 475

**Military pay; discharge; validity of discharge; Air Force regulations; compliance with necessary; homosexuality.**

[2] The board of officers convened pursuant to Air Force regulation 35–66 regarding homosexuality is a fact finding and recommending body, with the primary duty to develop and review all relevant information; if the board finds that the airman's case is in the Class II category, but recommends that he be retained in the service, the discharge authority only may approve that recommendation and may not approve discharge. While the discharge authority may set aside the board's findings and recommendations and direct appointment of a new board of officers, under para. 21b(7) of AFR 35–66 the decision to set aside must be supported by a demonstrable inconsistency between the evidence and the board's findings or between its findings and recommendation. Mere disagreement with the board's findings is not sufficient to authorize the discharge authority to set aside such findings. When the Commander (discharge authority) disapproved the board's findings and recommendation that plaintiff be retained in the service and directed appointment of a new board of officers to hear and consider the case against plaintiff without giving a reason and without satisfying the requirement of para. 21b(7), there was an abuse of the command function which rendered invalid subsequent proceedings leading to plaintiff's discharge.

Armed Services 🔑 22

**Military pay; discharge; validity of discharge; regulation of executive department; necessity for compliance with.**

[3] An agency is bound by its own regulations. When the procedures followed ignore pertinent procedural regulations or violate minimum concepts of basic fairness, a discharge issued to a serviceman prior to the expiration of his enlistment term is void.

Armed Services 🔑 22

**Military pay; reenlistment; right to.**

[4] A serviceman unlawfully discharged from the service during his term of enlistment does not have a right to reenlistment for a succeeding term, absent a statute giving him such right.

Armed Services 🔑 22

*Neil B. Kabatchnick*, attorney of record, for plaintiff. *Thomas H. King*, of counsel.

*Leslie H. Wiesenfelder*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before COWEN, *Chief Judge*, KASHIWA and BENNETT, *Judges*.

**PER CURIAM:** This case comes before the court on exceptions by the parties to a recommended decision filed by Trial Judge Kenneth R. Harkins pursuant to Rule 134(h). The court has considered the case on the briefs and oral argument of counsel. Since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby affirms and adopts the same as the basis for its judgment in this case. It is therefore concluded that plaintiff is entitled to recover active duty pay and allowances from July 3, 1962, to the end of his then current enlistment term, March 13, 1964, and judgment is entered for plaintiff to that effect with the amount of such recovery to be determined pursuant to Rule 131(c). On final order, an appropriate remand will be entered directing the Secretary of the Air Force to expunge all documents relative to plaintiff's invalid dismissal and to correct plaintiff's official military records.

## OPINION OF TRIAL JUDGE

HARKINS, *Trial Judge:* On July 3, 1962, plaintiff was discharged involuntarily for unfitness as a Class II homosexual from the Air Force prior to the expiration of his term of enlistment. His type of discharge precluded reenlistment. At the time of his discharge, plaintiff held the rank of staff sergeant, E-5, and had served a total of 17 years, 2 months, and 21 days of active military service in Korea, Japan, Okinawa, Germany, and Alaska. Plaintiff's term of enlistment would have expired on March 13, 1964; if he had continued in the military forces, his 20 years of active service for retirement eligibility would have ended on or about April 13, 1965. Plaintiff contests the validity of his involuntary discharge, and seeks judgment for active duty pay and allowances as a staff sergeant from July 3, 1962, to April 30, 1965; for the retired pay of a staff sergeant, computed on the basis of 20 years of active service, from May 1, 1965; and for correction of his military records to reflect reinstatement, reenlistment, and retirement.

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*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed March 6, 1974, they are not printed herein since such facts as are necessary to the decision are contained in his opinion.

Plaintiff's petition was filed on June 17, 1968, 16 days before the 6-year statute of limitations would have expired. In its answer, defendant asserted that plaintiff's claim was barred under the doctrine of laches, but defendant has not pursued this defense and has not made the required showing of prejudice.[1] The laches defense is deemed to be abandoned.

At issue is whether the action of the Secretary of the Air Force in effecting plaintiff's discharge violated minimum concepts of basic fairness and is invalid because the Air Force failed to comply with applicable regulations in its investigation and determination of the allegations against plaintiff. Defendant, also, puts at issue whether, in the circumstances of this case, plaintiff was entitled to a de novo hearing in this court on the propriety of his discharge.

The procedures employed by the Air Force do not satisfy the requirements of applicable regulations. The Secretary's approval of the recommendation to discharge plaintiff, accordingly, is invalid. In addition, inclusion of materials in the summaries prepared for the use of the Air Force Discharge Review Board (AFDRB) and the Air Force Board for the Correction of Military Records (AFBCMR) that had been discredited and excluded in the proceedings of the board of officers tainted each of the subsequent reviews and prejudiced plaintiff's right to fair and objective review proceedings.

The findings of fact detail the facts relevant to resolution of the issues of this case. The following statement summarizes those facts to the extent necessary to put the decision in perspective.

Plaintiff was stationed in Alaska from October 3, 1960, to June 30, 1962, with duty as a personnel specialist in Headquarters, 5010th Air Base Wing (ABWg) at Eielson Air Force Base. After December 4, 1961, plaintiff was in Headquarters, 5010th Air Base Group (ABGp), with his principal duty as the Test NCO, Classification and Testing Section, Headquarters, 5010th ABWg.

On November 17, 1961, the Office of Special Investigations (OSI), Detachment 8101, at Eielson AFB, commenced an investigation of plaintiff for alleged homosexual tendencies, at the request of the Air Police Division, 5010th ABGp. This investigation led to the institution of proceedings under the provisions of AFR 35-66[2] and resulted in plaintiff's involuntary discharge. The reports of the OSI investigation are not in evidence. A document (OSI Summary), completed on October 3, 1962, by an examiner of the Secretary of the Air Force Personnel Council (SAFPC), for use in proceedings of the AFDRB is in evidence.

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[1] *Cason* v. *United States*, 200 Ct. Cl. 424, 471 F. 2d 1225 (1973).

The OSI Summary discloses that allegations against plaintiff were made by three individuals, and were concerned with three separate incidents that were alleged to have occurred in plaintiff's room in the barracks on November 16, 1961, on November 17, 1961, and on an unspecified date in late October or early November 1961. Each of the individuals signed a written statement during the course of the OSI investigation, and the written statements were incorporated into the records of proceedings of the board of officers that resulted from the OSI investigation. The statement concerned with the November 16, 1961, incident (the Watts allegation) was made to the OSI special agent and was written and signed by Watts on November 20, 1961. The statement concerned with the late October-early November incident (the Kennedy allegation) was written by an OSI agent and was signed by Kennedy at an interview conducted on February 12, 1962. There is an ambiguity as to whether the statement concerned with the November 17, 1961, incident (the Reep allegation) was written on November 24, 1961, or on January 24, 1962.

The allegations against plaintiff were investigated at two proceedings of a board of officers, convened pursuant to AFR 35-66. Watts did not testify at either board; Reep testified at the first board, but not at the second; and Kennedy testified at both board proceedings.

At the time of the board proceedings, plaintiff, who is black, was 35 years old and had been on active duty in the Army or Air Force since April 1945. During his entire service, plaintiff never had been subjected to any form of disciplinary action. There is no evidence that plaintiff at any time has committed or participated in an act of homosexuality, nor that plaintiff knowingly consorted with known homosexuals. There are only two incidents—those involved in the Watts and Kennedy allegations—where there is evidence that plaintiff may have acted in such a manner that an act of homosexuality may have been proposed.

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[2] Discharge Processing Where Homosexual Acts or Tendencies Are Involved, Mar. 17, 1959.

The first board (1st board) proceedings were held on March 26–27, 1962, to investigate the allegation that plaintiff has homosexual tendencies, as defined by AFR 35–66, section B, paragraph 12b,[3] and to make findings and recommendations on whether plaintiff should be separated from the service as a Class II homosexual.

The findings and recommendation of the 1st board have been excised from the transcript of the proceedings. Trial in this court, however, established the 1st board found that plaintiff was a Class II homosexual and recommended plaintiff's retention in the service. By letter dated May 15, 1962, plaintiff was notified that the Commander, Alaskan Air Command (AAC), had disapproved the findings and recommendation of the 1st board and had directed that a new board be appointed. No reasons were given for the commander's disapproval of the findings and recommendation of the 1st board.

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[3] The regulation provides:

"12. Classification of Cases. Cases are generally classified as follows:

"a. *Class I.* Those cases where a member of the Air Force has engaged in one or more homosexual acts accompanied by assault or coercion, as characterized by an act in or to which the other person involved did not willingly cooperate or consent, or where the consent was obtained through force, fraud, or actual intimidation or where the homosexual act was committed with a minor, regardless of whether the minor cooperated.

"b. *Class II.* Those cases where a member of the Air Force has engaged in one or more homosexual acts, or has proposed or attempted to perform an act of homosexuality which does not fall into the Class I category. It is emphasized that no distinction is made in the administrative handling of cases of alleged participation in homosexual acts based upon whether the role of the person in any particular act was active or passive.

"c. *Class III.*

"(1) Those cases where a member of the Air Force exhibits, professes, or admits to homosexual tendencies, or habitually associates with persons known to him to be homosexuals, but there is no evidence that he has, *while a member of the Air Force*, engaged in one or more homosexual acts, or has proposed or attempted to perform an act of homosexuality.

"(2) Those cases where a member, *prior to becoming a member of the Air Force,* exhibited, professed, or admitted to homosexual tendencies, or habitually associated with persons known to him to be homosexuals, or who engaged in one or more homosexual acts, or proposed or attempted to perform an act of homosexuality, but there is no evidence that he has, *while a member of the Air Force,* engaged in or proposed or attempted to perform an act of homosexuality."

Proceedings of the second board of officers (2d board) took place on May 17–18, 1962. The presiding officer of the 2d board was the assistant administrative officer of the 5010th ABGp, who, in the absence of the group commander, at times served as acting group commander. In the period between the commencement of the OSI investigation and the 2d board proceeding, the president of the 2d board, on occasion, had been plaintiff's acting commanding officer with supervisory authority over plaintiff. In addition, the president of the 2d board, on May 17, 1962, had signed the endorsement to a notice dated May 16, 1962, to plaintiff from Wing Headquarters that the findings and recommendation of the 1st board had been disapproved.

The 2d board rejected, as not germane, the incident involved in the Reep allegation and accepted as valid the Watts and Kennedy allegations. The 2d board found that plaintiff did propose, or attempted to propose, an act of homosexuality as defined in AFR 35–66, section B, paragraph 12b, and a majority of the board recommended the issuance of a general discharge under AFR 39–17 (unfitness). A minority of the board recommended the issuance of an honorable discharge. On June 19, 1962, the Commander, AAC, approved the findings and recommendation of the 2d board and directed that plaintiff be given a general discharge.

Plaintiff applied three times to the AFDRB to have the proceedings leading to his discharge reconsidered and to request changes so that he could be permitted to reenlist. Plaintiff, represented by counsel, appeared before the AFDRB at hearings on January 3, 1963, on May 19, 1966, and on September 6, 1967. After each proceeding, the AFDRB found that plaintiff had been properly discharged, that the type of discharge was equitable and proper, and denied plaintiff's requests for corrective action to permit reenlistment.

Plaintiff appealed two times, on February 4, 1963, and on July 13, 1966, to the AFBCMR to request that his records be corrected to permit reentry into the Armed Forces. On both occasions, plaintiff's applications were denied without a hearing.

Each of the allegations against plaintiff on proposed acts of homosexuality involved separate but similar facts. Each incident was alleged to have occurred in plaintiff's room in the barracks, at night, and to have involved a note or a writing in which the act was proposed. None of the incidents involved verbal discussion of the alleged proposed act. Plaintiff denied the existence of either the meeting or the writing in the Reep allegation. Plaintiff acknowledged that he wrote the notes involved in the Watts and Kennedy allegations. Throughout all of the Air Force investigation and proceedings, and at trial, plaintiff has contended the writings were his personal notes of material to be included in a "party tape" of dirty jokes and were not intended to be propositions to engage in acts of homosexuality.

The incident in the Watts allegation took place on November 16, 1961. Watts, a black, was an airman in the Air Police Division and was considered by plaintiff to be a good friend. Plaintiff had administered Specialty Knowledge Tests to Watts three times in 1961: a "3 level" test that Watts passed and a "5 level" test in May that Watts had failed, and the retest in October. On November 14 or 16, 1961, plaintiff telephoned Watts, told him his score on the October test, and asked Watts to come to his room to discuss the paperwork involved in an upgrading to level 5. Disclosure of Watts' score before it was publicly available would have been a breach of regulations.

In his statement to the OSI, Watts said he reported plaintiff's call to the Air Police operations officer and was referred to an Air Police investigator. On November 16, 1961, Watts talked with the Air Police investigator, who had him call plaintiff and arrange to meet in plaintiff's room between 9 and 10 p.m. The Air Police investigator secured a wire recorder from the state police, which he had Watts conceal under his jacket, so Watts could record any conversation that took place. The Air Police investigator accompanied Watts to plaintiff's quarters and stationed himself in the hallway outside. At approximately 10 p.m., Watts entered plaintiff's room. Plaintiff was in bed, wearing shorts, a "T" shirt, and a bathrobe, and was watching television. Watts kept on his outdoor gear, refused an offer to sit down, and left the door open. Watts picked up a yellow-lined piece of paper from plaintiff's desk, table, or from the foot of the bed, started reading, and started to back out of the room. Plaintiff reached for the paper, but did not leave the bed or follow Watts into the corridor. Watts came out of the room, handed the Air Police investigator the yellow-lined paper, said he thought there had been a failure, and that plaintiff had not said anything out of line that could be recorded.

In his statement to the OSI, Watts said that plaintiff handed the note to him to read. Throughout all the proceedings, plaintiff has vigorously denied handing Watts the note, and has claimed that the note was written prior to Watts' entry into the room.

Standing alone, the note involved in the Watts allegation can be interpreted to be a proposition to engage in a homosexual act. It also can be interpreted to be material for a "dirty joke." The 2d board did not consider the intent of the note to be a joke or in fact to have any humor at all. The 2d board supported this conclusion by a finding that the content of the note did not appear on the "party tape." In this finding, the 2d board erred. The text of the note, in virtually identical language, identified as "The Dingler," is included in the material on the "party tape."

Watts departed Eielson AFB on rotation on February 20, 1962, and was not in Alaska at the time of the 1st board proceeding. Watts' departure occurred 12 days after plaintiff received (February 8, 1962) the AFR 35-66 letter of notification from the commanding officer and 1 day before the commander reported (February 21, 1962) the results of the OSI investigation to Wing Headquarters and recommended that plaintiff be separated from the service as a Class II homosexual. Although Watts departed Alaska on February 20, 1962, he was not released from active duty until March 6, 1964.

The Kennedy allegation stems from an OSI search of plaintiff's room on November 20, 1961. The OSI agents found 15 scraps of paper in the bureau drawer that, when re-assembled, formed an envelope that had plaintiff's handwriting on each side. Plaintiff has acknowledged that he had torn the envelope and thrown the pieces in the bureau drawer after he had shown the writing to Kennedy on a Saturday night in late October or early November 1961.

The writing on one side was addressed to "Ken" and asked a question about a "peppermint stick." There were blanks, designated "yes" or "no," to be marked by a checkmark. The other side of the envelope had an explanation of the question. A checkmark had been inserted in the blank marked "no." Standing alone, the language on the envelope involved in the Kennedy allegation can be interpreted to be a proposition to engage in a homosexual act. It also can be interpreted to be material for a "dirty joke." The 2d board concluded that the writing in the Kennedy allegation was not a joke but, in fact, was a proposition to engage in a homosexual act. Kennedy, in his written statement and in his testimony at each board hearing, stated he believed that the writing on the envelope was a proposition to engage in a homosexual act. Plaintiff, at all stages, has contended he only intended to test Kennedy's reaction to a dirty joke. The transcript of the "party tape" includes material on "The Peppermint Stick" in virtually identical language as that in the writing on the envelope that was shown to Kennedy.

The circumstances in which plaintiff handed the envelope to Kennedy bear upon the intent of the parties in the incident. Kennedy happened to be in plaintiff's room through a series of coincidences and, prior to that night, was virtually unknown to plaintiff. Kennedy is white. On the night of the incident, a group of men from Fort Wainwright had attended a service club show at Eielson AFB, but were prevented from returning to Fort Wainwright by car trouble. A casual friend of plaintiff's, Leonard Dean, who was one of the group, asked plaintiff to use his car to help start the stalled car. Unsuccessful in starting the car by pushing or by jumper cables, the group went to plaintiff's room to get warm, and, in the discussion that followed, plaintiff was asked to drive the group back to Fort Wainwright, a distance of from 24 to 26 miles. Plaintiff agreed on the condition that somebody would return with him so that there would be two people in the car in the event of a breakdown. The person who agreed to accompany plaintiff back, at first, was Dean. Later, Kennedy agreed to make the journey and to make the return trip to Fort Wainwright by bus.

During the return to Eielson AFB, which took about 30 minutes, Kennedy noticed that the bus on which he was to go back to Fort Wainwright had broken down. During the return trip, plaintiff and Kennedy engaged in general discussion of topics unrelated to sexual matters, and no sexual overtures or propositions were made or discussed.

After returning to Eielson AFB, Kennedy and plaintiff went to plaintiff's room to get warm, and Kennedy asked if he could spend the night. Plaintiff told Kennedy he could sleep there, put clean linens on his own bed for Kennedy, and secured a mattress from storage which he put on the floor to sleep on himself.

Plaintiff and Kennedy were in the room for 1 or 2 hours, during which time, for the most part, they watched television. There were no sexual overtures made or discussed. While Kennedy was watching the late show on television, plaintiff wrote the word "Ken" on the note and handed it to Kennedy. Plaintiff contends that the envelope already had writing on both sides when he handed it to Kennedy. Kennedy testified that there was writing on only one side when the envelope first was handed to him. Kennedy read the note, checked the blank marked "no," handed it back, and said "I don't quite understand what you are driving at." Plaintiff then said "Did you look at the back?" and gave the note back to Kennedy, who read the back and placed the note on the television. According to Kennedy, plaintiff wrote the language on the back of the note in explanation of the question before returning the envelope to him.

At the time, Kennedy did not pay too much attention to the note and was not disturbed by the incident. Plaintiff's reaction was to chuckle or snicker a little bit. When plaintiff showed the envelope with the writing to Kennedy, he did not touch Kennedy in any manner nor did he say anything nor do anything other than to hand him the note which could constitute a suggestion to engage in a homosexual act.

Within 5 minutes, plaintiff went to bed and Kennedy continued to watch the late show until it was over. Plaintiff awoke around 6 a.m. and awakened Kennedy by tapping him on the shoulder. Kennedy dressed and plaintiff gave him a dollar for bus fare back to Fort Wainwright.

The Reep allegation involved an incident that was supposed to have occurred shortly after midnight, November 17–18, 1961. Reep, who is white, testified at the 1st board proceeding, but did not testify at the 2d board; Reep's statement to the OSI special agent was incorporated into the record of each board proceeding. Plaintiff's testimony and supporting evidence at the 1st and 2d boards established that the incident could not have occurred at the time alleged because plaintiff was in Fairbanks, Alaska. For this reason, the Reep allegation was not accepted by the 2d board and was found not to be germane to proceedings against plaintiff. The incident described in Reep's statement to the OSI special agent has no support in this record and the credible evidence supports the conclusion that no meeting with plaintiff, as described by Reep, in fact occurred, and there is no evidence that a writing, as described in Reep's statement and alleged to have been handed to Reep by plaintiff, ever existed. Evidence in the record supports the conclusion that plaintiff did not make such a writing and, in fact, that such a writing did not exist. The writing attributed to plaintiff by Reep, as described in his statement, differs in nature and content from the writings involved in the Watts and Kennedy allegations, which plaintiff admits to have authored. The transcript of the "party tape" does not contain any material that is comparable to the writing described in Reep's statement.

## I.

Throughout this proceeding, defendant has asserted that a trial de novo was not warranted in the circumstances of this case. During pretrial, the trial judge denied defendant's motion that no oral testimony be permitted and that the case be decided only on the basis of the administrative decisions and records. Defendant's motion to review the trial judge's order was denied by the court on March 19, 1971. At trial, defendant's objection to the receipt of new testimony and evidence was overruled, and defendant declined to cross-examine plaintiff or to present new evidence. In its brief, defendant again presents the issue that plaintiff was not entitled to a de novo hearing and that any judicial review must be limited to the administrative record.

In military pay cases such as this judicial review is not limited to the administrative record as defendant argues. Plaintiff, in this court, is entitled to a trial on the merits, as a matter of right, so that he may have a judicial determination of the disputed factual issues involved in his claim.[4] In contrast to the situation in the contract cases cited by defendant, which limit judicial review to the administrative record, plaintiff has not contracted away his right to a judicial decision.[5]

In addition to removal of the case to a judicial forum from the purely administrative bodies that are designed to make recommendations for the exercise of military command discretion, the de novo proceeding in a military pay case generally elicits evidence that is new to the case. In this case, at trial plaintiff presented testimonial and documentary evidence that was not available for consideration in the Air Force proceedings. Of particular significance is the testimony of a member of the 1st board relative to the findings and recommendation that were excised from the transcript of the proceedings for the 2d board, as well as the testimony of plaintiff's medical expert with respect to plaintiff's psychiatric history for the period between October 1967 and November 1971.

In the trial de novo, deference is accorded the judgment and expertise of the administrative decision-maker by limiting judicial intervention only to those instances where the administrative decision, on the basis of all the evidence, was arbitrary, capricious, unsupported by substantial evidence, or inconsistent with applicable statutes or regulations. The substantial-evidence standard applies to review of the administrative decision, and the acceptance of new evidence has not encroached upon the administrative process.[6]

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[4] *Brown* v. *United States*, 184 Ct. Cl. 501, 396 F. 2d 989 (1968); *Beckham* v. *United States*, 179 Ct. Cl. 539, 375 F. 2d 782, *petition for writ of certiorari dismissed by stipulation*, 389 U.S. 1011 (1967), 183 Ct. Cl. 628, 392 F. 2d 619 (1968).

[5] *Montilla* v. *United States*, 198 Ct. Cl. 48, 57, 457 F. 2d 978, 983 (1972).

Evidence, to be substantial, must be evidence that would convince an unprejudiced mind of the truth of the facts to which it is directed. The substantial-evidence standard gives precedence to the administrative rulings when the record is viewed with the de novo evidence included in the whole.[7] The court has stated:

> Reasonable inferences fairly drawn from the evidence are for the administrative tribunal. Where two equally reasonable but contrary inferences might be drawn from the record, and each could be sustained as supported by substantial evidence, the one adopted by the Board should be sustained. Moreover, where conflicting testimony is in the record, the Board's preference will, generally, not be disturbed unless we can conclude that the findings are not supported by some evidence which qualitatively and, in appropriate circumstances, quantitatively, can be deemed substantial evidence when the record is viewed as a whole.

Reception of de novo evidence in this case was appropriate. The delicate and agonizing appraisal of all of the evidence, to resolve the merits of the Air Force findings that plaintiff had, in fact, proposed acts of homosexuality, and thus was a Class II case under AFR 35–66, however, is not required. Barracks or locker room humor is a difficult concept. It generally is sexual in nature and frequently is depraved and scatological. What is humorous depends much on circumstance and audience, and action connoted by the plain meaning of words employed is not necessarily implied and does not necessarily result. A most severe stigma attaches in our culture to male homosexuality; error in weighing the substantiality of the evidence that supports the Air Force findings could result in grave injustice. In this case, however, failure to comply with applicable regulations and procedural error are of such magnitude that the Secretary's decision cannot stand. Plaintiff is presumed innocent and only may be removed in the manner prescribed.[8]

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[6] *Brown* v. *United States*, *supra* note 4, 184 Ct. Cl. at 504, 396 F. 2d at 992; *Beckham* v. *United States*, *supra* note 4, 179 Ct. Cl. at 543–44, 375 F. 2d at 785.

[7] *Koppers Co.* v. *United States*, 186 Ct. Cl. 142, 149, 405 F. 2d 554, 558 (1968).

## II.

AFR 35-66 defines the procedures that apply to processing allegations that an airman is a homosexual. A board of officers convened under AFR 35-66 is required to conform, in addition, with the procedures established in AFR 11-1.[9]

The heading of AFR 35-66 declares that the regulation establishes procedures for processing three categories of Air Force personnel: Members who (1) engage in homosexual acts, (2) possess established and confirmed homosexual tendencies, or (3) habitually associate with individuals known to them to be homosexuals. The definitions for Class I, Class II, and Class III cases follow these three categories. The definition of a Class II case (*supra* note 3) literally applies to a single incident where an act of homosexuality is proposed or attempted. To give meaning to the second category described in the heading, cases in Class II, even though one incident may be sufficient for a classification of the case, should also show for the purposes of discharge that the person so charged possessed "established and confirmed" homosexual tendencies. This requirement is reinforced by the provisions in AFR 35-66, paragraph 20d, that permit a board of officers to recommend retention of an airman in a Class II case.

Paragraph 3 of AFR 35-66 announces four policy statements on homosexuality. Under these policies, a proposal to participate in a homosexual act is considered "a very serious misbehavior" and no distinction is made between an incident on duty time and an incident on off-duty time. It is the general policy of the Air Force to discharge members who fall in any of the Class I, II, or III cases. Although exceptions may be authorized to permit retention, such authorization is permissible "only where the most unusual circumstances exist, and provided the member's ability to perform military service has not been compromised." Extensive military service alone does not warrant an exception.

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[8] *Glidden* v. *United States*, 185 Ct. Cl. 515, 528 (1968).

[9] AFR 11-1, Administrative Practices, Boards of Officers for Conducting Investigations, Dec. 29, 1953, as amended.

Where investigation indicates that a case is in Class II and a general court-martial is not appropriate, if a hearing is requested, the regulation requires an airman's case to be referred to a board of officers. The functions and duties of the board of officers are purely administrative and pertain to airmen cases only. Primarily, the board of officers is a fact finding and recommending body with the primary duty to develop and review all relevant information.[10]

Paragraph 20 details board procedures and subparagraph "d" requires the board to announce its findings and recommendation to the airman and his counsel. When the board finds that the airman's case is in Class II, it may recommend (a) that the respondent be discharged and furnished an undesirable, general, or honorable discharge, as appropriate, or (b) that the respondent be retained in the service.

AFR 35-66 defines with particularity the action higher authority may take with respect to board findings and recommendations. If the board of officers has recommended that the respondent be discharged as a Class II case, paragraph 20b(1) authorizes the discharge authority to approve the discharge or to approve retention in the service if retention is deemed appropriate. If the board, however, has recommended that the respondent be retained in the service, the discharge authority only "may approve that recommendation and may not approve discharge." [11]

Paragraph 21 provides a procedure for the discharge authority to set aside the board's findings and recommendations and to direct appointment of a new board of officers. This procedure may be invoked if the findings of the board are not consistent with the facts in the case or if the recommendations of the board are not consistent with the findings. An amendment, effective January 12, 1961, requires that the decision to set aside the initial proceedings "must be supported by a demonstrable inconsistency between the evidence in the case and the board's findings or between its findings and recommendations." [12] Mere disagreement with the board's findings is not sufficient to authorize the discharge authority to set the board's findings aside.

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[10] Paragraph 17, in full, provides:

"17. Functions and Duties. The functions and duties of a board of officers convened under this regulation are purely administrative and pertain to airmen cases only, as officer cases are processed for final action under AFR 36-12 or AFR 36-2, as appropriate. Primarily, this is a fact finding and recommending board; it is not limited to the consideration of the file initially presented. The primary duties of the board are to develop and review all information concerning the matter under consideration; to arrive at clear, logical, findings of fact and conclusions; and to recommend, on the basis of these findings and conclusions, what action should be taken in the case (see paragraph 20d)."

[11] Paragraph 21b(5) reads as follows:

"(5) If the board has recommended that the respondent be retained in the service, the discharge authority may approve that recommendation and may not approve discharge."

Plaintiff was present when the 1st board announced its findings and recommendation. Plaintiff testified the 1st board found that he was a Class II homosexual and recommended that he be retained in the service.[13] A member of the 1st board testified at trial that he had a specific, clear, and independent recollection that the board of officers recommended plaintiff's retention in the service, but could not recall whether the board had found that plaintiff was a Class II homosexual. The findings and recommendation of the 1st board, in accordance with the requirements of AFR 35-66, paragraph 21b(7), were excised from the transcript and, accordingly, are not included in the administrative record.

When the Commander, AAC, disapproved the 1st board's findings and recommendation and directed appointment of a new board of officers to hear and consider the case, no reason was given. There is nothing in the administrative record, and nothing was presented at trial, to satisfy the requirement of paragraph 21b(7) that the "decision to set aside the initial proceedings must be supported by a demonstrable inconsistency between * * *." Failure to comply with this requirement, alone, would be sufficient to make the action of the discharge authority an abuse of the command function and would render invalid subsequent proceedings leading to plaintiff's discharge.

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[12] Paragraph 21b(7), as amended, reads as follows:

"(7) If the findings of the board are not consistent with the facts in the case, or the recommendations of the board are not consistent with the findings, the discharge authority may set aside the board's findings and recommendations and direct that a new board of officers be appointed to hear and consider the case. The decision to set aside the initial proceedings must be supported by a demonstrable inconsistency between the evidence in the case and the board's findings or between its findings and recommendations. A mere disagreement with the board's interpretation of the evidence, or with its recommendations, will not operate to authorize the exercise of this authority. When proceedings of the first board are set aside, no voting member of the new board may have been a member of the first board. If a new board is appointed the proceedings of the first board, less the findings and recommendations, will be forwarded to the new board for its information and consideration."

[13] In Requested Finding of Fact No. 50, defendant concurred.

AFR 35-66, paragraph 20d, permits the board, when it finds a Class II case, to recommend that the airman be either discharged or retained. Accordingly, the 1st board's findings and recommendation are not demonstrably inconsistent on their face. Further, evidence in the 1st board's record could support such findings and recommendation. Accordingly, the evidence and the 1st board's findings, on the record, are not demonstrably inconsistent. At a minimum, some statement from the Commander, AAC, in explanation of his action is essential for compliance with the requirements of AFR 35-66.

Disposition of the Watts allegation in the Air Force proceedings provides another instance of failure to comply with the requirements of applicable regulations. Paragraph 8 of AFR 35-66 applies to the separation or reassignment of military witnesses essential to board proceedings. It requires the commanding officer of an airman under investigation to ascertain the separation or reassignment status of any essential military witness. An essential military witness normally will not be reassigned until the case is closed or his presence is no longer required.[14]

Separation of an essential witness is prohibited until the case is closed or his presence is no longer required. In the event a witness is not available to testify in person, paragraph 8c requires him to be contacted for his affidavit or deposition. In such a case, "the action of the convening authority will contain a complete explanation and justification for the use of an affidavit or deposition."

Watts was not available to testify at either of the board proceedings. He departed from Eielson AFB on rotation on February 20, 1962, and was not in Alaska at the time of the 1st board proceeding. Watts' departure from Alaska in

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[14] Paragraph 8 reads, in part, as follows:

"8. * * * To provide for the availability of essential military witnesses in the event of board action, the immediate commander will promptly determine the separation or reassignment status of each such witness.

"a. A witness normally will not be reassigned from the jurisdiction of the major air command until the case under this regulation is closed or his presence is no longer required."

1962 was not due to any imminency in the expiration of his term of service because he was not released from active duty until March 6, 1964.

Watts was the air policeman whose complaint first gave rise to an investigation of plaintiff. Watts' visit to plaintiff's room on November 16, 1961, was at the behest of a sergeant in the Investigation Section of the Air Police Division to secure information for use against plaintiff. The factual details that surround acquisition of the note by Watts, which note plaintiff admits having written, have been in controversy throughout this case. Plaintiff had no opportunity at any stage of the Air Force proceedings to cross-examine Watts on any record as to these facts, as well as upon the facts that comprised the telephone conversations between Watts and plaintiff that preceded Watts' visit to plaintiff's room on November 16, 1961. No explanation or justification for the use of the Watts statement is given in the record, other than the assertion that Watts was no longer available in Alaska. No attempt was made, after the commanding officer's February 8, 1962, notice to plaintiff under AFR 35-66, or after the February 21, 1962, recommendation that plaintiff be separated as a Class II homosexual, to have Watts examined by deposition at his new post or to secure his affidavit. The statement Watts made to the OSI special agent on November 20, 1961, was a statement obtained during the course of an investigation and is not the "affidavit or deposition" required by paragraph 8c of AFR 35-66.

Failure of plaintiff's appointed military counsel in the first hearing to object to Watts' nonavailability and his failure to request Watts' appearance do not excuse noncompliance with the requirements of AFR 35-66. The circumstances surrounding the November 16th visit to plaintiff's room to obtain evidence, and in the light of the number of other irregularities in the Air Force proceedings in this case, the timing of Watts' departure on rotation from Alaska, and his resulting unavailability as a witness, underscore the need for strict compliance with required procedures.

The note obtained by Watts is one of two alleged proposals on which the 2d board based its recommendation for plaintiff's discharge. It emphasizes the essentiality of Watts as a witness. Failure of the Air Force in its proceedings to permit plaintiff to elicit, by cross-examination, relevant material facts on this note prejudiced plaintiff's ability to defend himself.

The significance of the facts surrounding the note acquired by Watts is shown by the 2d board. If plaintiff had been able to establish on the record that Watts picked up a note already written, as plaintiff contends, he may have been able to satisfy the 2d board that the note was in fact material for a joke. As it was, the 2d board based its acceptance of the validity of the Watts allegation on its determination that the text of the note was not a joke.

The foregoing failures in the Air Force proceedings to comply with applicable regulations are fatal defects in the administration of plaintiff's discharge. The law is well-established that an agency is bound by its own regulations.[15] When the procedures followed ignore pertinent procedural regulations or violate minimum concepts of basic fairness, a discharge issued to a serviceman prior to the expiration of his enlistment term is void.[16]

The OSI Summary completed October 3, 1962, purports to summarize four OSI reports which are not in evidence in this proceeding. The OSI Summary is a part of the administrative record and was included in the information available for use in each of the AFDRB and AFBCMR proceedings involved in plaintiff's case. The OSI Summary incorporates a digest of Reep's statement to the OSI agent and includes a paraphrase of a note allegedly written by plaintiff that is part of the Reep allegation. Reep's testimony, his statement, and the writing he attributed to plaintiff were discredited at the 2d board hearing and eliminated from the charges against plaintiff.

Notwithstanding the 2d board's elimination of the writing involved in the Reep allegation, the writing and the incident have been continuously renewed at each stage of plaintiff's efforts to defend himself. Defendant, at trial and in post-trial briefs, reasserts the credibility of the Reep allegation and the alleged note as viable in justification of the Air Force action. Information that lurks in the record when it properly should have been excluded is prejudicial.[17] The writing involved in the Reep allegation, by incorporation in the OSI Summary, tainted each of the AFDRB and AFBCMR proceedings and effectively frustrated the 2d board's determination that Reep's statement and testimony were unreliable. The writing attributed to plaintiff in the Reep allegation is inflammatory and is phrased explicitly as a proposition. Its continued inclusion for use in the subsequent proceedings clearly was prejudicial. It differs in content and style from the two notes plaintiff admittedly authored for use in preparation of a "party record."

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[15] *Vitarelli* v. *Seaton*, 359 U.S. 535 (1959); *Service* v. *Dulles*, 354 U.S. 363 (1957); *Cason* v. *United States*, *supra* note 1, 200 Ct. Cl. at 433, 471 F. 2d at 1230.

[16] *Waller* v. *United States*, 198 Ct. Cl. 908, 913, 461 F. 2d 1273, 1276 (1972); *Birt* v. *United States*, 180 Ct. Cl. 910, 913 (1967).

The Reep allegation was excluded by the 2d board; the Watts allegation should be excluded because he was not available for cross-examination as required by AFR 35-66 and AFR 11-1. The Kennedy allegation, standing alone, hardly would be sufficient to establish that plaintiff proposed or attempted to propose a homosexual act, as required for a Class II case under AFR 35-66.

In addition to violation of provisions in the regulations, there are an uncommon number of other errors or irregularities in the Air Force proceedings against plaintiff. Some of these irregularities are minor in nature; others are more significant. Taken together, however, these additional procedural errors and irregularities emphasize doubts that the Air Force proceedings possess the requisite elements of basic fairness.[18]

The president of the 2d board, in the interval between the institution of the investigation against plaintiff and the 2d board proceeding, had been plaintiff's acting commanding officer and had supervisory authority over plaintiff. The president of the 2d board, also, had endorsed the May 16, 1962, notice to plaintiff that the findings and recommendation of the 1st board had been disapproved. At the beginning of the 2d board hearing, the president, under oath, disclaimed any previous knowledge of the facts involved in plaintiff's case or of the results of the previous board hearing. A greater sensitivity for the appearance of fairness would have avoided creation of circumstances in which the president's impartiality was subject to challenge because of familiarity with plaintiff's case. In the circumstances, his service as president of the 2d board was inappropriate.

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[17] *Glidden* v. *United States*, *supra* note 8, 185 Ct. Cl. at 526.

[18] *Birt* v. *United States*, *supra* note 16, 180 Ct. Cl. at 913; *Clackum* v. *United States*, 148 Ct. Cl. 404, 296 F. 2d 226 (1960).

AFR 35-66 provides that the standard medical examination, recorded on Standard Form 88, Report of Medical Examination, is to include psychiatric consultation "if feasible." [19] Plaintiff's commanding officer on February 2, 1962, and on February 9, 1962, requested that plaintiff be given a medical and psychiatric evaluation for release from active duty under the provisions of AFR 35-66. Notwithstanding these requests, plaintiff was not examined by a psychiatric specialist. The medical doctor who examined plaintiff certified that he could "find no objective evidence of homosexuality" and testified that he had "insufficient evidence to make a definite diagnosis of a character disorder." No medical diagnosis was made in any of the Air Force proceedings that plaintiff was a homosexual or had homosexual tendencies.

Other irregularities in the record of the Air Force proceedings include an ambiguity as to whether Reep's statement was given on November 24, 1961, or January 24, 1962. There is also an ambiguity in the transcript of the proceedings of the 1st board. Presumably, the 1st board adjourned on March 27, 1962, after its findings and recommendation were read to plaintiff and his counsel. The transcript of the proceedings, however, states that the board closed on

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[19] Paragraph 14 provides, in part, as follows:

"14. How Cases Will be Documented and Forwarded. * * * All other cases which fall within the purview of this regulation will be documented and forwarded, as follows:

"a. The basic letter will be prepared and forwarded within 10 days following receipt of a completed report of investigation, or an initial or interim report of investigation where paragraph 11 applies. Any delay will be fully explained. The letter will also contain the following information, and will have the enclosures indicated:

* * * * *

"(11) Standard medical examination, recorded on Standard Form 88, 'Report of Medical Examination,' to include psychiatric consultation, in accordance with AFM 160-1, if feasible."

April 27, 1962, and adjourned on April 27, 1962, to meet at the call of the president.

### III.

Plaintiff seeks judgment for active duty pay and allowances as a staff sergeant from July 3, 1962, to April 30, 1965, and for the retired pay of a staff sergeant based on 20 years of active service from May 1, 1965. Upon entry of judgment for compensation, plaintiff also seeks further relief as authorized by Pub. L. No. 92–415.[20] Plaintiff's discharge on July 3, 1962, was invalid. He is entitled to recover active duty pay for the period from his invalid discharge to the end of his then enlistment term, March 13, 1964. It cannot be said that plaintiff would have been reenlisted in 1964 and allowed to remain in the service until he had 20 years of active military duty. As a matter of law, plaintiff had no such right; the Air Force well might have refused to permit reenlistment.[21] In the circumstances of this case, however, plaintiff is entitled to an appropriate order of remand that requires defendant to expunge from the records of the Air Force all documents relative to his invalid dismissal.

### CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover active duty pay and allowances from July 3, 1962, to the end of his then current enlistment term, March 13, 1964, and judgment is entered to that effect. The amount of recovery is reserved for further proceedings under Rule 131(c). On final order, an appropriate remand will be entered directing the Secretary of the Air Force to expungs all documents relative to plaintiff's invalid dismissal and to correct plaintiff's official military records.

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[20] Act of August 29, 1972, Pub. L. No. 92–415, 86 Stat. 652, and General Order No. 3 of 1972 of this court.

[21] *Davis* v. *United States*, 196 Ct. Cl. 517, 523 (1971), *cert. denied*, 405 U.S. 1046 (1972); *O'Callahan* v. *United States*, 196 Ct. Cl. 556, 560–63, 451 F. 2d 1390, 1392–93 (1971); *Clackum* v. *United States*, 161 Ct. Cl. 34 (1963).

515 F. 2d 1116

# THE ARUNDEL CORPORATION v. THE UNITED STATES

[No. 24-73. Decided May 14, 1975]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; disputes; changed conditions; quantity variation in excavated rock; substantial evidence; expert testimony.**—Following a prebid site investigation, plaintiff contracted to construct for a fixed price, using materials from a designated borrow area, 10.6 miles of levee along the northeast side of Lake Okeechobee in Florida. Plaintiff claims entitlement to compensation for 97, or alternatively 82, additional working days resulting from changed conditions materially differing from subsurface conditions indicated in the contract documents, contending that by reason of the excessive quantities of hard and very hard rock it encountered during contract performance and the overall ratio of rock to other materials, its daily productivity was hampered, the presence of excessive rock being manifested by the unusual wear and tear on dredge equipment, especially the unusually high replacement of certain parts. Plaintiff's claim was denied by the contracting officer and the Corps of Engineers Board of Contract Appeals. Plaintiff seeks Wunderlich Act review of the board's decision, maintaining that the decision was arbitrary and not supported by substantial evidence. During administrative proceedings plaintiff submitted a report of a qualified geologist which stated that in general the ratio of material that could be classified as rock to the total volume of material represented at the various locations he surveyed was considerably higher than the ratio indicated by the contract's core borings. Defendant's expert testified that the boring logs were consistent with the geology of the area. Since no data was presented reflecting what percentage of material excavated actually consisted of rock, the board found that the reports of the two experts did not differ materially and that the greater amount of rock revealed in plaintiff's report was a result of a terminology difference as to what material was classifiable as rock; the board also found that the alleged excessive replacement of dredge equipment parts and extended performance time were not conclusive evidence of a changed condition. It is *held* (1) that the board's conclusion as to the terminology difference in the experts' reports was reasonable on the basis of the total record, plaintiff having failed to meet its burden of proving that the conclusion was improper or not supported by substantial evidence; (2) that the board did not err in excluding "soft rock" and certain "rock" of a borderline nature as a claim factor; (3) that lacking evidence of what equipment replacement would normally be, the board could hardly decide what was abnormal or excessive replacement, and accordingly the board's conclusion in this regard was reasonable; (4) that plaintiff has presented nothing establishing that the board's conclusion relative to rejection of extended performance time as proof of changed conditions is erroneous; and (5) that plaintiff's claim fails since the board's decision is reasonable and supported by substantial evidence. Plaintiff is not entitled to recover, its motion for summary judgment is denied, defendant's cross-motion is granted and the petition is dismissed.

**Contracts; disputes; administrative record; supplementation of record.**

[1] It is permissible in Wunderlich Act review proceedings to supplement the facts as recited by the contract appeals board for purposes of explanation, clarity of presentation or proper perspective, as long as the supplementary facts are undisputed or uncontroverted.

United States ⚷ 73(15)

**Contracts; Boards of Contract Appeals; evidence; weight and sufficiency.**

[2] It is the prerogative of the contract appeals board to assess the weight to be given the totality of the evidence.

United States ⚷ 73(15)

**Contracts; disputes; administrative decision; substantial evidence.**

[3] Since a matter before the contract appeals board is a de novo proceeding, whether or not certain reports of investigation conducted by one party were before the contracting officer when he rendered his decision is immaterial in the court's resolution of the substantiality of the board's determination. Inferences resulting from the failure of a party to introduce into evidence certain materials is more properly for the board to draw than the court.

United States ⚷ 73(15)

**Contracts; disputes; administrative decision; finality of on question of fact.**

[4] Where a contractor seeks an equitable adjustment based on a category 1 changed condition, the determination of what conditions were actually encountered by the contractor during contract performance is factual in nature; the administrative board's resolution of fact disputes is entitled to finality where supported by substantial evidence and not otherwise arbitrary. Thus, although the court may well disagree with the board's decision adverse to the contractor and might decide the question differently if faced with it as an original matter, unless the contractor can establish that the decision suffers from Wunderlich Act disabilities, the court is precluded from exercising its independent judgment in order to reach a contrary

conclusion. In seeking to set aside the board's factual determinations the contractor carries a heavy burden.

United States 🔑 73(15)

**Contracts; disputes; administrative decision; substantial evidence; conflicting testimony.**

[5] In a contract dispute respecting a category 1 changed condition, the contract appeals board is free to resolve and/or reconcile conflicting investigative reports of experts based on its expertise in technical matters and an assessment of the credibility of the witnesses and the probative value of their testimony. In these areas, the board, as the trier of facts, is presumed to have acted properly and correctly. Plaintiff has the burden of rebutting these presumptions.

United States 🔑 73(15)

**Evidence; weight and sufficiency of evidence; uncontroverted evidence.**

[6] Even uncontradicted opinion testimony is not conclusive if it is intrinsically nonpersuasive.

Evidence 🔑 568(1)

**Contracts; changed conditions; subsurface conditions differing from indications in contract.**

[7] Where the record in this case indicates that there is no universally accepted definition of rock and that geologists differ in the language they use to classify materials, in resolving the contractor's claim that it encountered a materially greater quantity of rock than was indicated by the contract documents and thus a category 1 changed condition existed, the contract appeals board in exercising its judgment and expertise properly excluded "soft rock" and certain "rock" of a borderline nature as a claim factor since these materials did not cause difficulty in the dredging process.

United States 🔑 70(22)

**Contracts; disputes; administrative findings; burden of proving error in.**

[8] A contractor has the burden of establishing that the administrative record does not support the findings of the board, and it is not the court's function on judicial review to make an independent excursion into the record to remedy this failure.

United States 🔑 73(15)

**Contracts; disputes; administrative findings; substantial evidence.**

[9] Absent evidence of what was normal replacement for dredge cutting equipment, the contract appeals board could hardly decide what was abnormal or excessive replacement as an indication of the claimed occurrence of a category 1 changed condition because the quantity of rock encountered in a borrow area greatly exceeded that which the contractor expected from the contract documents.

United States 🔑 73(15)

**Contracts; changed conditions; subsurface conditions differing from indications in contract.**

[10] Extended contract performance time by itself is not proof of encountering changed conditions.

United States ⚷ 70(22)

*Richard H. Nicolaides*, attorney of record, for plaintiff. *J. Cookman Boyd, Jr.*, of counsel.

*Ray Goddard*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before COWEN, *Chief Judge*, KASHIWA, and BENNETT, *Judges.*

PER CURIAM: This case comes before the court on plaintiff's request, filed November 1, 1974, for review by the court of the recommended decision, filed August 2, 1974, by Trial Judge Thomas J. Lydon, pursuant to Rule 166(c) on plaintiff's motion and defendant's cross-motion for summary judgment and on defendant's motion, filed January 14, 1975, for adoption by the court of the recommended decision. The case has been submitted to the court on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. It is, therefore, concluded that plaintiff is not entitled to recover, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and plaintiff's petition is dismissed.

## OPINION OF TRIAL JUDGE

LYDON, *Trial Judge:* On December 6, 1965, plaintiff entered into a contract with defendant, acting through the Department of the Army, Jacksonville, Florida District, Corps of Engineers, wherein it agreed to construct, for the contract price of $1,814,258, some 10.4 miles of levee along the northeast side of Lake Okeechobee in Martin and Okeechobee Counties, Florida. The levee, designed for flood protection purposes, was to be constructed from material to be obtained from a continuous borrow area parallel to and on the landside of the levee. During excavation of the borrow material, plaintiff alleged that it had encountered changed conditions materially different from subsurface conditions indicated in the contract documents. Specifically, plaintiff alleged it encountered a materially greater quantity of rock than was indicated by the contract documents. Plaintiff's claim based on changed conditions was denied by the contracting officer on August 28, 1968, and thereafter denied by the Corps of Engineers Board of Contract Appeals (hereinafter the Board) on January 8, 1971 (71-1 BCA #8669). Plaintiff herein seeks review of the Board's decision that it did not encounter changed conditions during contract performance pursuant to the standards of the Wunderlich Act (68 Stat. 81 (1954), 41 U.S.C. §§ 321 and 322 (1970)). Plaintiff maintains that the Board's decision was arbitrary and not supported by substantial evidence. It claims entitlement to compensation for 97 additional working days resulting from the changed conditions it encountered in the amount of $1,422,242. In the alternative, plaintiff contends it is at least entitled to compensation for 82 additional working days in the amount of $1,202,366. After a careful review of the administrative record and the briefs of the parties, it is concluded that the Board's determination that plaintiff did not encounter changed conditions[1] during contract performance is entitled to finality in accordance with the Wunderlich Act.

## I.

Plaintiff's Florida District Manager, James W. Wilkerson (Wilkerson) was responsible for assembling information pertinent to the submission of plaintiff's bid on the proposed levee work. In this bid preparation work, Wilkerson considered information germane to the borrow area from a number of sources, including 26 boring logs furnished as contract documents by defendant,[2] 15 additional borings at locations which were between or offset from the 26 Government borings referred to above made by plaintiff during its prebid site investigation, and pertinent geological publications and maps from both the United States Geological Survey and the State of Florida Geological Survey. Wilkerson was not a geologist, but had considerable experience in dredge excavation work.[3] The Board found, and it is uncontested herein, that plaintiff made an adequate prebid site investigation and that the contract documents fairly represented the information available to defendant as to site and subsurface conditions at the various core boring locations. Nor is there any dispute that the subsurface investigations made by the Government, as manifested in logs of 26 core borings within or immediately adjacent to the continuous borrow area, properly portrayed the subsurface condition at each bore hole location and that there were medium hard, hard and very hard formations of rock, among other materials, within the limits of the the borrow area. Moreover, it is clear that plaintiff's borings in general confirmed the data reflected in the Government's borings. Indeed, the additional borings made by plaintiff demonstrated that the various strata reflected in the Government's boring logs were discontinuous and subject to material variations within relatively short distances.

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[1] Plaintiff advised in its moving brief that the sole issue in this case is whether or not the conditions encountered by plaintiff during contract performance materially differed from those indicated in the contract documents. The Changed Conditions (Article 4) clause of the contract in question provided in pertinent part:

"The Contractor shall promptly, and before such conditions are disturbed, notify the Contracting Officer in writing of (a) subsurface or latent physical conditions at the site differing materially from those indicated in this contract, or (b) unknown physical conditions at the site, of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in this contract * * *."

Subpart (a), *supra*, is referred to as a "Category 1" changed condition and subpart (b) is referred to as a "Category 2" changed condition. While there is loose language in the briefs implying that both categories are involved in this case, it is concluded that the dispute is only concerned with a Category 1 changed conditions claim.

In his bid preparation work, Wilkerson divided the borrow area into nine sections and calculated the number of days he estimated it would take to excavate each section. Wilkerson's time projections were based on his estimate of the ratio of easily dredged material to the indicated quantity of rock manifested by the subsurface information available to him. Wilkerson placed great reliance, in arriving at his estimates, on past production records on other excavation projects performed with a hydraulic dredge called the "Admiral." He also relied on his own prior experience in dredging work. His own prior experience took on greater import when a new hydraulic dredge, called "The General," which had never been used previously, was scheduled for use on this project. Accordingly, prior production records of work done by the Admiral were less significant than would be the case if the Admiral had been assigned to the levee project. With the new dredge, Wilkerson had to rely on its anticipated unproven design capacity. Wilkerson's daily estimated volume of excavation production was 48,000 cubic yards in sections evaluated as 98 percent or more sand, 38,000 cubic yards in sections evaluated as having 12 to 14 percent rock, and 22,000 cubic yards in section 9, where the boring logs indicated some 31.7 percent rock. Wilkerson estimated that 240 days would be required to excavate the estimated 9,671,700 cubic yards of material in the borrow area. This would indicate that plaintiff would have to excavate an average of 40,300 cubic yards per day. The fact that the dredge was used in the borrow area a total of 97 days more than the estimated 240 days is claimed by plaintiff to be due solely to the presence of changed conditions.

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[2] Plaintiff made no effort to examine the core borings themselves although they were available for inspection and the Invitation for Bids invited inspection thereof. The core borings were subsequently lost and not available at the time of the Board hearing. Whether their availability would have made a difference in the result reached, or the rationale employed, by the Board is pure conjecture.

[3] In some instances it has been found necessary to supplement the facts as recited by the Board for purposes of explanation, clarity of presentation or proper perspective. This is permissible in Wunderlich Act review proceedings as long as the supplementary facts are undisputed or uncontroverted. *See e.g., Liles Constr. Co.* v. *United States,* 197 Ct. Cl. 164, 183, 455 F. 2d 527, 537 (1972); *Maxwell Dynamometer Co.* v. *United States,* 181 Ct. Cl. 607, 612–13, 631, 386 F. 2d 855, 859, 870 (1967).

Dredging operations began on April 1, 1966, and work proceeded smoothly through sections 1, 2 and 3. The Government's boring logs for the area covered by these sections (station 924+30 through 746+50) indicated that no rock would be encountered and plaintiff found that the material actually excavated corresponded with the data reflected on the logs. While working in section 4, on or about July 14, 1966, plaintiff contends it began to encounter substantially greater quantities of rock than it believed was indicated in the contract documents. With the exception of some eleven days in November 1966, plaintiff alleged it continued to experience more rock than it anticipated until it completed its dredging operations on or about March 11, 1967.[4]

There are two separate areas in which plaintiff claims it encountered changed conditions. The first area is located between stations 746+50 and 568+50 (sections 4 and 5) and involved work performed from July 14, 1966 until November 11, 1966. The Government's boring logs indicated the presence of rock in these sections in varying degrees and at varying depths. The second area is located between stations 540 and 401+50 (sections 7, 8 and 9) and involved work performed from November 25, 1966 to March 11, 1967. The Government's boring logs indicated the presence of rock in these sections in varying degrees and at various depths.

In light of the rock indications on the contract boring logs, plaintiff did not contend that the presence of rock in the borrow area constituted a changed condition. Indeed, plaintiff anticipated encountering rock and that is why it had a rock cutter available for installation on the dredge. It did contend that the quantity of hard and very hard rock in some sections, and the overall ratio of rock to other materials, greatly exceeded that which it anticipated from its examination of the contract documents and other information available to it in its prebid investigation. While plaintiff contends it maintained records which segregated the materials excavated, such records were not available at any time material herein.[5] Accordingly, plaintiff relied on expert testimony to estimate the percentage of rock it actually encountered in dredging material from the borrow area. These estimates, which exceeded the rock estimate indications in the contract drawings, formed the core of plaintiff's argument to the Board that it encountered substantially greater quantities of rock than it reasonably anticipated from a review of the contract documents.

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[4] On September 9, 1966, plaintiff formally notified the Area Engineer, Corps of Engineers, it had encountered substantial rock in the borrow area but that the extent of this changed condition was not known at that time. Subsequent letters of November 29, 1966, and December 19, 1966, advised that subsurface changed conditions continued to be encountered but that the full extent thereof could not then be determined. On September 1, 1967, plaintiff made a formal claim for an equitable adjustment due to encountering changed conditions, substantial quantities of rock, during contract performance.

[5] The Board noted that the "Captain's Daily Report," reflecting daily operation of the dredge, which was part of the record, only showed total yardage excavated, with no break down of materials excavated. The Board also noted that defendant's daily logs gave percentages of the character of the materials excavated, but that the monotonously repetitious nature of the daily rock percentage figures set out in these daily reports cast some doubt on the reliability of the same. In these circumstances, concluding that the burden of proof in establishing the quantity of rock rested with plaintiff, the Board held that the defendant's daily logs supported defendant's position that the quantity of rock excavated was not significantly and materially different from that indicated on the Government's boring logs. The Board's conclusions in this regard are supported by the record as well as by the Board's prerogative to assess the weight to be given the totality of the evidence.

Plaintiff employed a geologist, Dr. H. Kelly Brooks, to study the borrow area in question. Dr. Brooks was an Assistant Professor of Geology at the University of Florida and also served as a consultant at various times on geological matters. The borrow area was under water at the time of Dr. Brooks' study in March–May 1967 and his study was directed at the banks (east and west) of the canal created by the excavation of the borrow area in question. Dr. Brooks used scuba diving gear and artificial light to examine the bank areas. He tested underwater the east and west bank materials with a special hammer and the responses thereto guided him in classifying the materials inspected. In general, soft materials, as opposed to hard materials, will produce, when hit with such a hammer, either a thud or no sound at all. He also took samples of materials from various locations on the banks and later examined them on the surface for hardness qualities. In this underwater investigation, Dr. Brooks obtained data every 200 feet at each survey station on the east bank and every 400 feet, or at every other survey station on the west bank. From this extensive underwater investigation and analysis, Dr. Brooks prepared a stratigraphic diagram of the borrow area wherein he interpolated the results of his investigation and analysis of the east and west banks of the canal to cover the excavated area separating said banks.[6] In his report on his investigation and analysis Dr. Brooks stated that in general the ratio of material that could be classified as rock to the total volume of material represented at the various locations he surveyed was considerably higher than the ratio indicated by the Government's core borings in the same general area. Specifically, Dr. Brooks found that there was 15.9 percent rock between stations 736 and 564 as compared to 10.5 percent rock indicated in the Government's boring logs (this is roughly equivalent to the first area where plaintiff claimed changed conditions), and 24.5 percent rock between stations 562 and 401 as compared to the 12.8 percent rock indicated in the Government borings (this encompasses generally the second area where changed conditions were claimed).[7] The Board carefully examined the report of Dr. Brooks.

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[6] Dr. Brooks viewed this extensive underwater investigation and stratigraphic analysis as a unique feat in the field of geology. He defined "stratigraphy" as "[t]he tracing and origin of the different layers of rock and actually it gets to the dates and ages of these materials and the origin." Dr. Brooks also conceded that stratigraphy was not an exact science and that he had to correlate and interpolate in reaching his rock percentage estimates, conceding that his results reflect some artistic imagination and artistic liberty (Tr. 220–21, 232, 273).

Defendant also conducted investigations relative to the claim of changed conditions. One investigation was made by Government personnel and another by a private firm, Geotechnical Engineering of Lakeland, Florida. This firm submitted a report on its investigation, which, it appears, was also the result of a scuba diving operation. Neither of these investigations, which undoubtedly played a role in the decision reached by the contracting officer, was in the Board record.[8] However, since a matter before the Board is a *de novo* proceeding, *Monroe Garment Co.* v. *United States*, 203 Ct. Cl. 324, 345, 488 F. 2d 989, 1001 (1973), whether certain materials were before the contracting officer or not is immaterial when determining the substantiality of the Board's determination.

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[7] When some inconsistencies were brought to Dr. Brooks' attention between his report and the dredge's production records, he advised plaintiff's President by letter dated August 22, 1968, that his "diagrams record the rock at the sides of the borrow canal. We will never know the exact amount of rock that was actually excavated by the dredge. It may be considerably more or less than that occurring to either side at any one particular station." In short, the inconsistencies were that in some areas where Dr. Brooks estimated various rock percentages of 9.4 percent (section 4), 21.7 percent (section 5) and 16.7 percent (section 8) dredge production was generally the same. These estimates were inconsistent with plaintiff's contention that dredge production was affected by the amount of rock encountered.

[8] Dr. Brooks prepared an evaluation of the Geotechnical report but it too was not a part of the Board record. While plaintiff contends that unfavorable inferences should be drawn from the failure of the Government to introduce the results of these investigations into evidence before the Board or to produce as witnesses individuals associated with said investigation, the record indicates that plaintiff, aware of these investigations, had ample opportunity to make the reports part of the Board record or request or attempt to obtain the presence at the hearing of these individuals (*see* Tr. 277–82). More importantly, under such circumstances, inferences such as plaintiff seeks here, much like the element of credibility, are more properly for the Board to draw, or determine, rather than the court. *See Chaney & James Constr. Co.* v. *United States*, 190 Ct. Cl. 699, 717, 421 F. 2d 728, 738 (1970); *see also Seger* v. *United States*, 199 Ct. Cl. 766, 795, 469 F. 2d 292, 309 (1972).

After the contracting officer's decision on August 12, 1968, a section of the borrow area between stations 536 and 470 (this was in the second area of claimed changed conditions) was dewatered down to an elevation of minus 3.3 feet, and representatives of both parties given an opportunity to examine and classify the various strata exposed on the banks of the dewatered area. At various locations in the dewatered area trenches were excavated to remove surface material and to expose undisturbed subsurface material.

Dr. Brooks conducted the investigation of the dewatered area on plaintiff's behalf. He did not plot the west bank of the canal because, "the section on the west side are so badly covered even my original data was poor * * *" (Tr. 147). Dr. Brooks spent 11 days in April–May 1969 at the dewatered site where he examined the exposed east bank of the canal at 200-foot intervals. For the area between stations 536 to 470, Brooks testified his study showed there was 27.8 percent rock which he compared to the 9.86 percent rock indicated in the six Government log borings most applicable to the dewatered area. At the request of Dr. Brooks three other geologists also spent a day or two at the dewatered site; and they were in general agreement with Dr. Brooks' findings relative to the strata present in the area, believing Dr. Brooks was more conservative in his rock estimates than they would have been. The record does indicate that these geologists did not always classify the materials as did Dr. Brooks. The Board, and rightly so on this record, gave more attention to Dr. Brooks' testimony than to the testimony of the other three geologists since it was more detailed. *See Northbridge Electronics* v. *United States*, 195 Ct. Cl. 453, 460–62, 444 F. 2d 1124, 1128–29 (1971).

The Board in its opinion set out in chart[9] form a comparison of the data reflected in six Government boring logs applicable to the dewatered area with the results obtained by Dr. Brooks in his 1969 dewatered area investigation. This chart discloses that on average, the material associated with the six core borings was composed of some 12 percent rock.[10] The corresponding rock percentages from Dr. Brooks' study are, on average, 10.5 percent when only rock classified as medium to very hard is considered, and 25.8 percent when "soft rock" is included.

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[9] A careful examination of the record indicates that the Board's rock percentage figure of 20.5 percent, medium hard, for Core Bore No. 9A, is incorrect and should instead reflect a rock percentage figure of 17.7 percent. This error, however, does not materially impinge on the integrity of the Board's overall analysis or conclusions relative to the comparisons it made.

Dr. Robert Vernon, Chief of the Bureau of Geology for the State of Florida, investigated the dewatered area on behalf of defendant. He spent 4 days in April–May 1969 at the dewatered site, surveying the east bank at 200-foot intervals and the west bank at 400-foot intervals. After studying the applicable Government boring logs, and based on his investigation of the dewatered area, Dr. Vernon testified that the boring logs compared favorably with the materials he found during his survey of the dewatered area. In general, he also testified that the total Government boring logs were consistent with the geology of the area. Dr. Vernon estimated there was an average of 12 percent rock in the dewatered area.

The Board found that although Dr. Vernon's report used different descriptive terms in classifying materials than did Dr. Brooks in his report relative to their investigations of the dewatered area, a careful examination of both reports convinced it that there were no major differences between the two geologists, "having in mind that the issue here involved is whether or not the contractor encountered an excessive amount of rock which would not break down into material which could be handled by the 26-inch hydraulic dredge." (Bd. Dec. pp. 11–12).[11] The higher percentage of

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[10] The 12 percent figure is greater than the 9.86 percent figure computed by Dr. Brooks. The difference can be attributed to the fact that the Board in its computations used the total depth of the boring log from the surface to elevation minus 3.3 feet, the depth to which the area was dewatered, which was the same depth used by Dr. Brooks in his 1969 study and computations, and not the original core boring project depth of minus 8 feet. If Dr. Brooks in comparing his 1969 study results with a minus 3.3 feet elevation used the core boring data to the same minus 3.3 feet elevation, he would have presumably arrived at the same approximate percentage the Board did.

[11] Plaintiff argues that this characterization of the issue involved by the Board is incorrect, advising that the issue is whether or not the conditions encountered were materially different from those indicated on defendant's boring logs. On this record, it would appear plaintiff is engaging in semantics.

(Continued)

material classified as rock by Dr. Brooks included, the Board found, material classified by him as "soft rock," whereas Dr. Vernon classified that same "soft rock" as loosely cemented, irregularly case-hardened material. Finding that the conclusions, properly analyzed, of the two geologists were in general agreement, the Board extrapolated these results to cover the entire borrow area in question and concluded that the differences between the parties as to the character of the material encountered was one of terminology rather than substance (Bd. Dec. p. 12).

The basis of plaintiff's claim before the Board was that the quantity of rock it encountered in the borrow area greatly exceeded that which it anticipated from an examination of the contract documents and other information available to it during the prebid investigation period. In support of its claim plaintiff advanced before the Board the following contentions: (1) Estimated productivity of the dredge was decreased in sections 4, 5, 7, 8, and 9 of the borrow area causing work to continue for 97 additional days more than the 240 estimated scheduled workdays. This entire delay period is attributed by plaintiff to the encountering of excessive quantities of rock, viewed as changed conditions, which hampered daily production; (2) The presence of excessive rock was manifested by the unusual wear and tear on the dredge equipment, especially the unusually high replacement of rock cutter teeth and main pump runners and liners; and (3) The testimony and reports of expert geologists, especially Dr. Brooks, support the asserted changed conditions claim.

The Board, after careful consideration of the record evidence, found "that the core boring logs contained in the contract documents fairly represented the conditions logged by Dr. Brooks and Dr. Vernon relative to their dewatered area study. We also consider that Dr. Brooks' investigation

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(Continued)
In its phraseology, the Board was simply giving due regard to the reasonable conclusion that only rock which caused plaintiff difficulties should be considered in determining the validity of the changed condition claim. Hence, if "soft rock" or loosely cemented materials posed no problems, it should not be considered as changed condition material. In any event, the phraseology used by the Board has no effect on the ultimate conclusions reached by the Board.

and report [obviously referring to the 1967 underwater investigation] do not support a finding that conditions actually encountered were materially different from those indicated in the contract documents" (Bd. Dec. pp. 15–16). Further, the Board stated that, "we cannot find that the alleged excessive replacement of wearing parts on the dredge or the extended performance time are conclusive evidence of a changed condition due to the lack of proof as to the amount of wearing parts replacement normal to work of the character involved and a performance time related to the actual volume of material dredged during performance of the contract work absent the alleged changed condition." Plaintiff takes issue with several determinations made by the Board relative to its final decision, and these challenges are treated below.

## II.

As indicated previously, it is clear that we are concerned with a category 1 changed conditions claim. Plaintiff contends that an issue of law is involved, in some manner, in the Board's decision and the court has no finality restrictions in interpreting what the contract indications are relative to a category 1 changed conditions claim. *McKee* v. *United States*, 205 Ct. Cl. 303, 500 F. 2d 525 (1974). It is clear beyond cavil that interpretation of contract documents is a judicial function to be performed independently of any Board decision. *Foster Constr. C.A.* v. *United States*, 193 Ct. Cl. 587, 601, 435 F. 2d 873, 880 (1970). However, this established proposition is not for application herein because the dispute in this case does not center on what was indicated by the contract document [12] but what conditions were actually encountered by plaintiff during contract performance. This latter determination is purely factual in nature [13] and resolution by the Board of factual disputes is entitled to finality where supported by substantial evidence and not otherwise arbitrary. *Dale Ingram, Inc.* v. *United States*, 201 Ct. Cl. 56, 69, 475 F. 2d 1177, 1184 (1973); *Ivy H. Smith Co.* v. *United States*, 154 Ct. Cl. 74, 82–83 (1961). Under these circumstances, even though the court may well disagree with the Board's decision and might decide the question differently if faced with it as an original matter, unless plaintiff can establish that the Board's decision suffers from Wunderlich Act disabilities, it cannot recover. *H. N. Bailey & Associates* v. *United States*, 196 Ct. Cl. 166, 185, 449 F. 2d 376, 387 (1971). Too, a plaintiff who seeks to set aside the factual determinations of a Board carries a heavy burden. *Donald M. Drake Co.* v. *United States*, 194 Ct. Cl. 549, 553, 439 F. 2d 169, 171 (1971).

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[12] Indeed, there is general agreement as to what the contract indications were. They indicated the presence of rock in varying degrees in sections 4 through 9 of the borrow area, and rock was encountered during contract performance. The question is whether materially greater quantities of rock, substantially in excess of amounts indicated in the contract documents, were encountered.

[13] *Lenry, Inc.* v. *United States*, 156 Ct. Cl. 46, 49, 297 F. 2d 550, 551 (1962); *Henry E. Wile Co.* v. *United States*, 144 Ct. Cl. 394, 399, 169 F. Supp. 249, 252 (1959).

In determining whether or not the actual quantities of rock encountered during performance were excessive in relation to the amounts of rock one could reasonably anticipate from a study of the contract boring logs, the Board did not have the benefit of data reflecting what percentage of the material excavated actually consisted of rock. What it did have were estimates of the percentages of rock which geologists believed probably existed in the area excavated based on their survey station examinations of the banks of the excavated area and subsequent interpolation of the data which they believed comprised the banks.[14] Faced with this situation, the Board had to resolve and/or reconcile the conflicting reports of qualified geologists in order to reach a factual determination of what the subsurface conditions actually were in the excavated borrow area. This determination involved, to some degree, reliance by the Board on its expertise in technical matters, *H. N. Bailey & Associates* v. *United States*, *supra*, 196 Ct. Cl. at 184, 449 F. 2d at 386, and certainly involved an assessment of the credibility of the witnesses and the probative value of their testimony.

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[14] The boring logs of the Government and the plaintiff clearly showed the discontinuous nature of the subsurface strata which was subject to material variations within relatively short distances. *Cf. Farnsworth & Chambers Co.* v. *United States*, 171 Ct. Cl. 30, 34, 346 F. 2d 577, 580 (1965). Thus the projections of the geologists were clearly of a kind that were not absolute. Indeed, Dr. Brooks, as noted above, advised that one would "never know the exact amount of rock that was actually excavated." Dr. Brooks also conceded that it was possible to have a rock shelf along the bank and there may not be any corresponding rock shelf in the area that was excavated (Tr. 179).

*Seger* v. *United States*, 199 Ct. Cl. 766, 795, 469 F. 2d 292, 309 (1972). In these areas, the Board, as the trier of facts, will be presumed to have acted properly and correctly. *Chaney & James Constr. Co.* v. *United States*, 190 Ct. Cl. 699, 720–21, 421 F. 2d 728, 740 (1970). These presumptions can be rebutted but it is plaintiff's burden to do so.

Plaintiff first argues that the Board erred in giving any consideration to Dr. Vernon's report and rock estimates, based on his 1969 investigation of the dewatered area of the excavation canal, in determining whether or not plaintiff encountered excessive rock in the borrow area. Plaintiff contends that Dr. Vernon's report only covered the dewatered area (stations 536 to 470), which was only a portion of the second area (stations 540 to 401+50) where changed conditions were alleged to have been encountered, and did not cover the first area (stations 746+50 to 568+50) of alleged changed conditions at all. Since the only evidence in the record covering the entire borrow area was the report by Dr. Brooks based on his underwater study of the banks of the excavated canal in 1967 and his graph and profile comparison of his rock estimates based on said study with the Government's core boring log rock estimates, plaintiff argues the Board was compelled to accept this evidence as submitted without question. The Board, however, was not persuaded by Dr. Brooks' 1967 underwater survey results (Bd. Dec. p. 16), and "[e]ven uncontradicted opinion testimony is not conclusive if it is intrinsically nonpersuasive." *Sternberger* v. *United States*, 185 Ct. Cl. 528, 535–36, 401 F. 2d 1012, 1016–17 (1968); *see also Northbridge Electronics, Inc.* v. *United States*, *supra*, 195 Ct. Cl. at 462, 444 F. 2d at 1129 (1971).[15] Indeed, the court, when faced with a somewhat similar attack on a Board decision in a situation involving opposing geologists refused to say that the Board was compelled to disregard one geologist's opinion because, *inter alia*, he only inspected one-half of a tunnel. *Carlo Bianchi & Co.* v. *United States*, 167 Ct. Cl. 364, 376 (1964), *cert. denied*, 382 U.S. 841 (1965).

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[15] This underwater study and resulting stratigraphic profiles and diagrams were admitted to be a novel and unique geological first by Dr. Brooks. Indeed, he knew of no reputable geologist who performed this type of survey. There was testimony in the record by Dr. Vernon that one could easily conclude while working underwater there was more rock present than was actually the case. In the dewatered area, he discovered no rock where Dr. Brooks, based on his underwater study, indicated rock (Tr. 684–99). Visibility and overlay material also presumably hampered such work. Under these circumstances, the Board reasonably could be unpersuaded by this type of study. *See H. N. Bailey & Associates* v. *United States*, *supra*, 196 Ct. Cl. at 185, 449 F. 2d at 387.

In the dewatered area, both Dr. Brooks and Dr. Vernon made investigations unhindered by water and resulting visibility restraints. As noted previously, the Board concluded that Dr. Vernon's report was in substantial agreement with Dr. Brooks' report relative to the results, properly analyzed, each obtained from an investigation of the dewatered area. Once this was determined, the Board extrapolated these results to cover the entire borrow area in issue[16] and concluded that the difference between the two experts was one of terminology (*i.e.*, descriptive terms used to classify materials) rather than substance (Bd. Dec. p. 12). An examination of these reports and a careful review of the total record discloses that the Board's conclusion was a reasonable one to draw therefrom. Indeed, on the briefs before the court, plaintiff has not made a convincing case which would indicate that the Board's conclusion was improper or not supported by substantial evidence. Accordingly, it has failed to meet its heavy burden in this regard and the Board's conclusion of fact must stand. *Teitelbaum* v. *United States*, 198 Ct. Cl. 150, 161–63, 458 F. 2d 72, 78–79 (1972).[17]

Plaintiff vigorously maintains that vital differences existed in the reports of Dr. Brooks and Dr. Vernon. Plaintiff's comparison chart, directed at the two reports, does reveal differences between them, even when "soft rock" is excluded from Dr. Brooks' total rock figures. In some instances, Dr. Vernon's rock measurements at a given point exceed those recorded by Dr. Brooks. For example, at station 484, Dr.

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[16] The Board's resort to extrapolation to cover the entire area was reasonable under the circumstances. It is noted that Dr. Brooks in his study interpolated data from surveyed areas to cover areas not surveyed or investigated. He defended this technique in view of the large area involved (Tr. 206, 219–20, 232). The Board cannot be faulted for employing a similar technique.

[17] Plaintiff, in its briefs, details various pieces of evidence before the Board and, in effect, asks the court to reweigh this evidence and overturn the Board's factual conclusions drawn from the record as a whole. In cases of this type, the court cannot reweigh the evidence independently. *Chaney & James Constr. Co.* v. *United States*, *supra*, 190 Ct. Cl. at 724, 421 F. 2d at 742

Brooks found 14.4 percent rock on the east bank that he classified as medium to very hard, whereas Dr. Vernon found some 25.88 percent rock in this area. At station 486, the corresponding rock figures were 13.5 percent for Dr. Brooks and 25.74 percent for Dr. Vernon. At other stations, the situation was reversed with Dr. Brooks finding more rock than Dr. Vernon.[18] On the basis of this comparison chart alone, the court is unable to conclude that the Board's treatment of the experts' testimony and documentary evidence on the basis of the total record is lacking or devoid of vitality, *cf. Wm. A. Smith Contracting Co.* v. *United States*, 188 Ct. Cl. 1062, 1073, 412 F. 2d 1325, 1330–31 (1969).

Plaintiff maintains that the Board erred in excluding "soft rock" and certain "rock" of a borderline nature which would have no appreciable effect on the dredging operation (Bd. Dec. pp. 12 and 17). The record in this case indicates that there is no universally accepted definition of rock. The record also indicates that geologists differ in the language they use to classify materials. The Board noted that Dr. Vernon classified "material as being loosely cemented, irregularly case hardened" whereas Dr. Brooks' classification of the same material would describe "several layers as sand and shell, semiconsolidated with some soft rock" (Bd. Dec. p. 12).[19] Under these circumstances, the Board carefully examined the record before it and noted those areas (stations 924+30 and 746+50) where plaintiff did not claim changed conditions, ostensibly because it had no difficulty in excavating the materials, and also noted the penetration blows per foot data reflected in the six Government boring logs pertinent to this area indicating the hardness of the subsurface materials, before concluding "that partially cemented materials requiring less than 25 blows per foot for penetration, which could be classified as 'soft rock' are not a factor in this claim,"[20] since "soft rock did not cause difficulty in the dredging process and was not considered to be a changed condition" (Bd. Dec. p. 15). Thus the Board established a reasonable basis on which to gauge the hardness of materials described in the various reports for purposes of trying to estimate whether excessive rock was encountered. As a result, it is difficult to appreciate plaintiff's assertion in its brief that there is absolutely no reference to any portion of the record justifying the Board conclusions in this regard. On this record, the Board's approach to resolution of the rather nebulous problem before it must be accepted. The Board's statement, justifying this approach, that, "[t]his point [the exclusion of "soft rock"] is further bolstered by the fact that there is no direct analogy between the percentage of rock found in the various sections of the borrow area as originally broken down by the appellant and the actual dredge production when operating within the sections," (Bd. Dec. p. 15), while unchallenged, is brushed aside as irrelevant by plaintiff. But it is relevant in explaining why the Board, deprived of data reflecting actual amounts of rock excavated and burdened with expert reports which classified materials differently, established a reasoned and fair method to try and determine whether excessive difficulty-causing rock was actually encountered by plaintiff. Plaintiff fails in its burden to establish error on the part of the Board in excluding "soft rock" from Dr. Brooks' figures. *Sundstrand Turbo* v. *United States*, 182 Ct. Cl. 31, 60, 389 F. 2d 406, 422–23 (1968). It is not the court's function to make an independent excursion into the administrative record to remedy this failure. *See Jefferson Constr. Co.* v. *United States*, 177 Ct. Cl. 581, 589, 368 F. 2d 247, 252 (1966). Furthermore, even when the record is closely examined, one cannot say that the Board's analysis and conclusion were arbitrary or not supported by substantial evidence. Once again, the conclusion reached by the Board relative to exclusion of "soft rock" as a claim factor is the product of judgment and expertise and without overriding evidence to the contrary the court is precluded from exercising its own independent judgment in order to reach a contrary conclusion. *Carlo Bianchi & Co.* v. *United States*, *supra*, 167 Ct. Cl. at 368.[21]

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[18] For example, Dr. Brooks measured 16.6 percent rock at station 520, whereas Dr. Vernon measured 3.5 percent rock; at station 518, Dr. Brooks measured 16.6 percent rock whereas Dr. Vernon measured 1.12 percent rock. At station 516, Dr. Brooks recorded 21.8 percent rock and Dr. Vernon reported 4.18 percent rock.

[19] Even the other geologists who testified on plaintiff's behalf classified some materials differently than did Dr. Brooks (Tr. 318–23, 368–73, 397–98). It would appear that Dr. Brooks recorded as rock what others considered cemented or hardened sand and shell (*see* Tr. 130, 236–38, 274; Tr. 318–24, Tr. 397–98; *cf.* Tr. 480, 499, 503–04, 563; Tr. 660–85, 691–99).

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[20] Wilkerson, plaintiff's Florida District Manager, supported the Board in this regard, when he stated he thought the classification of rock would begin anywhere from 25 blows per foot and up, but hastened to add "that doesn't means that you can't run into material that won't get a blow count like hard-packed sand and if you don't know what you are in, it will drive just as hard as a softer grade of rock." (Tr. 107) Both the Government's prebid borings and the plaintiff's prebid borings classified rock by blows per foot and were comparable (*see* Bd. Dec. p. 14; Tr. 104–07, Tr. 497–500).

Plaintiff next argues that the Board completely disregards all testimonial evidence concerning the unusually high replacement of dredge cutting equipment as an indication of the occurrence of changed conditions. The truth is the Board did not disregard this evidence, but, in considering it, found such evidence to be of little or no probative value because there was a lack of evidence in the record as to the amount of wear and replacement normally to be expected when dredging materials undisputedly shown in the contract documents. The weight the Board gives the evidence is one of its prerogatives and unless clearly shown to be erroneous, the court will not disturb its conclusion drawn therefrom. *Chaney & James Constr. Co.* v. *United States*, *supra*, 190 Ct. Cl. at 724, 421 F. 2d at 742. Lacking evidence of what was normal replacement, the Board could hardly decide what was abnormal or excessive replacement. Moreover, plaintiff proffered no evidence as to the classification of material which actually went through the dredge, evidence which might have had some bearing on whether, in fact, excessive rock quantities were the cause of such alleged excessive wear and replacement. The only records that were available, containing the only information in this regard, were the Government's daily logs, and the Board found, and plaintiff has not adequately challenged the finding herein, these logs and their material classifications supportive of a conclusion that no changed conditions were encountered.

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[21] While not determinative herein, it bears remembering that plaintiff made its own borings, and presumably inflated its bid costs to cover such expense, indicating it did not rely completely on the Government's boring logs. See in this regard *Foster Constr. C.A.* v. *United States,* 193 Ct. Cl. 587, 613–14, 435 F. 2d 873, 887 (1970). We need not decide if this action by plaintiff constituted a significant indication of nonreliance on the contract indications such as to defeat a category 1 changed conditions claim. *See Perini Corp.* v. *United States,* 180 Ct. Cl. 768, 778–82, 788, 381 F. 2d 403, 409–12, 415 (1967) ; *see also T. F. Scholes, Inc.* v. *United States,* 174 Ct. Cl. 1215, 1225–26, 357 F. 2d 963, 969–70 (1966).

In its brief, plaintiff seeks to provide evidence of what could normally be expected with respect to replacing equipment. Before the Board, plaintiff produced a chart entitled "Tabulation of Replacement Due To Abrasive Wear." Plaintiff, utilizing this chart, points to the period November 12, 1966–November 24, 1966 (encompassing dredge work between stations 568+50 and 540+75). No changed condition, because no difficulty was encountered in working this area, was claimed here although Dr. Brooks estimated 16.7 percent rock for this area and the Government's boring log (station 550) indicated that approximately 13.3 percent of the material in the area would be rock. Plaintiff contends that replacements which were made while working this non-changed conditions area with 13.3 percent of the material considered rock, can be viewed as normal replacements and thus provides the necessary comparison tool for determining what is excessive. Analysis of the Tabulation Chart and the other evidence of record does not support plaintiff's contention.[22] For example, during the entire month of September 1966, when plaintiff was working in an area where it claims changed conditions, only 128 new cutter teeth were needed whereas during the period November 12–24, 1966, while working in an area where no changed conditions are alleged, and which plaintiff considers a normal work area, some 223 cutter teeth were replaced. This certainly casts serious doubt on the validity of plaintiff's contention based on replacement data. The Board's conclusion in this regard must be accepted.

Finally, plaintiff takes issue with the Board's refusal to find the extended performance time by itself was proof of encountering changed conditions (Bd. Dec. p. 18). The Board observed that there may be a number of explanations why the estimated performance time was exceeded.[23] As an example, the Board cited the fact that a simple overrun in the material dredged could be viewed as accounting for 15 days of the 97 days which plaintiff claimed resulted solely from the changed condition.[24] Plaintiff presents nothing by way of record citation, or otherwise, which establishes that the Board's conclusion relative to rejection of extended performance time as proof of changed conditions is in any way erroneous. As indicated earlier, it is plaintiff's burden to show that the record before the Board does not support its findings and conclusions. *Sundstrand Turbo* v. *United States*, *supra*, 182 Ct. Cl. at 60, 389 F. 2d at 422–23.

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[22] Plaintiff also complains because the Board was not persuaded by the testimony of Wilkerson relative to wear and replacement. However, aside from the Board's right to judge the probative value of testimonial evidence, the testimony of Wilkerson was far from enlightening on wear and replacement and what was normal replacement. His testimony did indicate that sand alone has a wearing effect when going through the dredge (*see* Tr. 89–98), and the record indicates that replacement of parts took place during periods when no changed conditions were alleged to have been encountered.

To be successful on a category 1 changed conditions claim, the actual conditions encountered must differ materially from those indicated on the contract documents or reasonably to be expected from an examination thereof. Here, plaintiff contends the actual conditions were that plaintiff encountered significantly greater amounts of rock from what it reasonably anticipated or had a right to expect. The Board, on the record before it, could not make the necessary factual findings which would support such a contention, and thus plaintiff's claim must fail since the Board's decision is reasonable and supported by substantial evidence. *J. A. Terteling & Sons* v. *United States*, 182 Ct. Cl. 691, 700–02, 390 F. 2d 926, 931–32 (1968).

## CONCLUSION

In light of the foregoing, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, and plaintiff's petition is dismissed.

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[23] It is to be remembered that the dredge used was a new one. There is some evidence in the record that production may have been affected by the operational condition of the dredge (*see* Tr. 785, 814–16, 825, 844–53). Too, plaintiff's production estimates were based primarily on the operations of a tried and tested dredge, the "Admiral."

[24] Plaintiff does not contest this observation by the Board. Instead, it adopts it as the basis for an alternative claim utilizing 82 days as the extended period which resulted from the alleged changed conditions.

518 F. 2d 1341

# MASON & HANGER-SILAS MASON CO., INC. v. THE UNITED STATES

[No. 616-71. Decided June 25, 1975]*

ON THE PROOFS

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered in determining excessiveness.**—Plaintiff operates four Government-owned ammunition plants (GOCO) pursuant to cost-plus-fixed-fee contracts subject to the Renegotiation Act of 1951, as amended. Under the two contracts with the Army Procurement and Supply Agency, plaintiff operated two plants and was paid a fixed fee per unit of ammunition produced. Under the two AEC contracts, plaintiff was paid a single annual fee for management of two plants. Operation of the four plants represents approximately 99% of plaintiff's renegotiable business which in turn is substantially all of plaintiff's business. The question for decision is whether the profits earned by plaintiff in 1967 were excessive under the Act and, if so, to what extent. Plaintiff supports its position that its profits in 1967 were not excessive with contentions, among others, that it operated with high efficiency, made a substantial contribution to the defense effort, and that the 2.37% ratio of its profits to receipts was lower than the average profit ratio of GOCO ammunition plants. Defendant contends that the 80% increase in plaintiff's receipts in 1967 over 1966 was brought about by an increased demand for ammunition for the Vietnam War and that the resulting increase in profits from the Army contracts of 139% is disproportionate and is excessive by not less than $500,000, the amount demanded in its counterclaim. After a review of the history, and legislative and judicial interpretation of the Renegotiation Act, it is *held* (1) that plaintiff deserves favorable consideration for its substantial manufacturing contribution; (2) that plaintiff is entitled to favorable recognition for a high degree of efficiency; (3) that plaintiff is entitled to favorable consideration for experimental and developmental work of high value to the defense effort, if not also for new inventions, techniques and processes of unusual merit, as well as contributions to the defense effort through its work with large quantities of dangerous materials under hazardous conditions; (4) that plaintiff is not entitled to favorable consideration by reason of risks assumed since under GOCO contracting the Government supplies and risks the capital; (5) that plaintiff is not entitled to favorable consideration under the net worth factor; (6) that on the basis of statistics furnished

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*See Order dated October 3, 1975 on plaintiff's motion for reconsideration and additional trial, *post* at 183.

the court, 1965 is viewed as an historical base year of normal or peacetime earnings for plaintiff for purpose of comparison pursuant to 32 C.F.R. § 1460.10(b)(1); that the increase in production made no financial demands on plaintiff, the necessary increases in costs of training, recruitment, materials, equipment and facilities being paid for by the Government; that the two comparisons required by the regulation for determining reasonableness of costs and profits lead to widely divergent conclusions: on the one hand, comparing plaintiff's 1967 profits with normal or peacetime earnings, it appears that its profits were excessive to a very great extent, that its profit margin should be reduced from 2.37% to less than 1.66%, the comparison with other GOCO contractors, on the other hand, suggests that plaintiff's margin of profit is not excessive in any degree; and (7) that, on the basis of all relevant factors, including the statutory factors, industry experience and the contracting officer's view, plaintiff's renegotiable profits in 1967 were excessive in the amount of $423,000, and, as a percentage of sales, plaintiff's profits are thus found to be non-excessive to the extent of about 2%. Plaintiff's petition is dismissed and judgment is entered on defendant's counterclaim for $423,000, less appropriate state and federal tax credits, plus interest thereon as provided by law.

**Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.**

[1] In a de novo renegotiation proceeding before this court, the burden of proof of excessive profits rests on defendant.

War and National Defense 🔑 59

**Renegotiation of contracts; Renegotiation Act; purpose of Act.**

[2] The premise of statutory renegotiation was that accurate pricing and the control of contractors' profits cannot be achieved during a build-up of production for defense of war. The purpose of the Act was to control by recapture the sky-rocketing profits on goods produced for war and national emergency without impeding either the volume or efficiency of that production.

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**Renegotiation of contracts; redetermination of excessive profits; factors to be considered.**

[3] The statutory factors to be considered in determining excessive profits (50 U.S.C. App. § 1213(e)) provide for all the possible differences in renegotiation cases—the character of the business, its efficiency, the contribution to the defense effort, the net worth and capital employed, the risks assumed, the reasonableness of costs and profits and any others required to do equity and serve the public interest. No single fact or factor is determinative and all must be taken into account.

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**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; contribution to defense effort; superior performance.**

[4] The contractor who performs a defense contract does not by that token make a contribution within the meaning of the Renegotiation Act. Favorable consideration is rather due a contractor for superior performance or performance, assistance or service considered otherwise exceptional.

War and National Defense 🔑 59

**Evidence; weight and sufficiency of evidence; generally.**

[5] In the context of the present case, absent challenge by the Government, the statement of plaintiff's general manager that plaintiff made an inventive and developmental contribution to the defense effort in performance of the contract is accepted as that of an expert, and must be taken as a reconsideration and retraction of an earlier opinion presented by the Government during administrative proceedings that plaintiff did not make an outstanding contribution to the defense effort.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; contribution to defense effort; superior performance.**

[6] In determining the amount of excessive profits realized by a defense contractor, favorable consideration should be given to the contractor's development of improved techniques, cooperation with other Government contractors and foreign governments, and high quality work under difficult and hazardous conditions.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; extent of risk assumed.**

[7] Risk to the contractor is practically eliminated in Government-owned, contractor-operated, "cost-plus" defense contracting—the Government supplies and risks the capital; none of the "sales" of the contractor is made at a fixed price; costs are reimbursed; and profit margins are assured.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; "know-how" as capital asset.**

[8] In renegotiation, "know-how" has been recognized as a capital asset as a means of calculating proper compensation or allowable profit, but where the present plaintiff contributed no capital to the enterprise and all the "know-how" was obtained at the cost of the Government, it is inappropriate to treat such "know-how" as an asset and to add the substantial value thereof to the capital devoted to plaintiff's business. The products of "public capital" should not be converted to "private capital."

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Syllabus

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; risk of losses.**

[9] In determination of the amount of excessive profits realized under a defense contract, the maintenance of reserves in event the contract were to be terminated for convenience of the Government and the contractor required to use the capital to reenter other business, is neither a true risk nor among the risks to be considered under the statutory factors set forth in 50 U.S.C. App. § 1213(e).

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**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; reasonableness of costs and profits.**

[10] In determining the reasonableness of costs and profits, comparisons should be made with the contractor's own costs and profits in previous years, and with current costs and profits of other contractors, if such information is available.

War and National Defense 🔑 59

**Renegotiation of contracts; Renegotiation Act; construction and operation; reasonableness of costs and profits.**

[11] It is a cardinal principle of statutory renegotiation that where expanded war production decreases unit costs and increases the contractor's profits without exceptional effort and without corresponding increases in costs, the Government should normally get the principal benefit in more favorable prices, or in renegotiation. This is especially true where capital and plant come from the Government.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof.**

[12] Where the contractor was unable reasonably to obtain data with respect to the individual contractors which comprise the industry averages, the contractor met its burden of going forward by placing in the record the industry averages alone.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; public interest and fair dealing.**

[13] Although Sec. 103(e)(6) contemplates future adoption and publication by the Board of other factors the consideration of which the public interest and fair and equitable dealing may require, nonadoption is not a bar to consideration by the court of such other factors, if any.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; public interest and fair dealing.**

[14] The renegotiation process requires that a balance be struck between the public's interest in prices for war materiel at fair and

uninflated prices and the contractor's right to fair and equitable treatment.

War and National Defense ⚷ 59

**Renegotiation of contracts; redetermination of excessive profits; factors to be considered; reasonableness of costs and profits.**

[15] The contracting officer's view of what was a reasonable level of the contractor's fees is not controlling on the court although it is one element to be evaluated.

War and National Defense ⚷ 59

**Renegotiation of contracts; redetermination of excessive profits; evidence; burden of proof and persuasion.**

[16] The Government has met its burden of proof to show excessiveness of profits realized by plaintiff in performance of its GOCO contract where the Government has demonstrated, including presentation of expert testimony, that plaintiff's risks were virtually non-existent, that plaintiff invested little capital, and that plaintiff's rise in profits was due to increased wartime volume without competition and with no downward adjustment in fees for increased quantity.

War and National Defense ⚷ 59

*Numa L. Smith, Jr.*, attorney of record, for plaintiff. *Emil V. Pilz*, *Barron K. Grier*, *James W. Midgley*, *Miller & Chevalier*, of counsel.

*John Charles Ranney*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This renegotiation case comes before the court on appeal from the Trial Division where findings and an opinion were filed August 9, 1974, by Trial Judge David Schwartz, pursuant to Rule 134(h). His decision has been reviewed on the briefs, exceptions, and oral argument of counsel. Upon consideration thereof, the court finds itself in agreement with major portions of that recommended decision and adopts them, with minor modification, as Parts I–VII and IX of its opinion. Most of the trial judge's findings of fact are also adopted, but with some modifications we deem proper upon consideration of exceptions by the parties. Our departure from the trial judge's analysis and conclusions is limited essentially to Parts VIII and X of this opinion.

## I

Plaintiff operates four Government-owned ammunition plants (called GOCO plants for Government-owned, contractor-operated) pursuant to contracts with Government agencies subject to the Renegotiation Act of 1951, as amended. Title I, ch. 15, 65 Stat. 7 (1951), as amended, 50 U.S.C. App. §§ 1211–24 (1970), as amended (Supp. II, 1972). The question for decision is whether the profits earned by plaintiff in 1967 were excessive under the Act and, if so, to what extent.

Two of the four plants are nuclear ordnance plants operated for the Atomic Energy Commission. In these plants plaintiff assembles the nuclear weapons stockpiled by the United States from high explosives produced at the plants and nuclear and other components supplied by the AEC through other GOCO contractors. The other two plants are conventional ammunition plants, operated for the Army Procurement and Supply Agency (APSA), in which plaintiff loads, assembles and packs a variety of ammunition products. In 1967 these plants were the major source of high explosive bombs used by the Air Force.

The financial basis of the operation of each plant is a cost-plus-fixed-fee contract under which the Government furnishes the plant and equipment and reimburses all costs, except the cost of plaintiff's corporate overhead at its home office. Under the Army contracts, plaintiff was paid a fixed fee per unit of ammunition. Under the AEC contracts plaintiff was paid a single annual fee for management of the two plants.

The operation of the four plants represents approximately 99 percent of plaintiff's renegotiable business, which in turn is substantially all of plaintiff's business.

In 1967 plaintiff's total receipts subject to renegotiation were $112,931,469. After deducting from its fixed fees the $822,000 in nonreimbursable costs of overhead, plaintiff was left with net profits subject to renegotiation of $2,681,800.

The percentage relationship of the profits to the receipts is 2.37.

The Renegotiation Act in its opening section declares it to be the considered policy of the Congress "in the interests of the national defense and the general welfare" to eliminate "excessive profits," "as provided in this title," from contracts made with the United States for procurement and construction for the national defense program. 50 U.S.C. APP. § 1211 (1970). The Renegotiation Board, an agency created by the Act, is charged with the responsibility of recapturing excessive profits earned on these contracts, in practice the contracts of the military, maritime, space, aviation and atomic energy agencies and the General Services Administration. Provision is made for various exemptions and minimum profits not subject to renegotiation. On the basis of data required to be filed by each contractor who holds contracts or subcontracts subject to the Act, the Board negotiates with the contractor for a refund of excessive profits earned in a given fiscal year. If agreement is not reached, the amount of profit deemed excessive is determined by the Board in a unilateral order, 50 U.S.C. APP. §§ 1212–17 (1970), as amended (Supp. II, 1972). A contractor aggrieved by such an order may within a specified period file a petition in this court for a redetermination of the amount of his excessive profits. 50 U.S.C. APP. § 1218 (1970), as amended (Supp. II, 1972).

That is what happened here. The plaintiff, aggrieved by an order of the Board determining that it received excessive profits of $500,000 in 1967, has filed a petition under section 108 of the Act for a redetermination of the amount of its excessive profits. The nature of the proceeding and the determination are explicitly described in the Act: "The court may determine as the amount of excessive profits an amount either less than, equal to, or greater than that determined by the Board." 50 U.S.C. APP. § 1218. The proceeding in the Court of Claims, the Act continues, "shall not be treated as a proceeding to review the determination of the Board, but shall be treated as a proceeding de novo." 50 U.S.C. APP. § 1218 (1970), as amended (Supp. II, 1972); *see Lykes Bros.*

*S.S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972). The question now presented is thus not whether the Board was correct in its decision or can be shown to be incorrect, but rather an original question to be freshly determined, namely, what amount, if any, of plaintiff's profits in 1967 from contracts subject to renegotiation was excessive under the Act. While some of the evidence before the Board has been introduced in this proceeding, a trial de novo has been held, witnesses heard and exhibits introduced. The burden of proof of excessiveness rests on defendant. *Lykes Bros. S.S. Co.* v. *United States, supra.*

Plaintiff supports its position that its profits in 1967 were not excessive with contentions, among others, that it operated with high efficiency, made a substantial contribution to the defense effort, and that the 2.37-percent ratio of its profits to receipts was lower than the average profit ratio of GOCO ammunition plants. The Government's position is that the 80-percent increase in plaintiff's receipts, in 1967 over 1966, was brought about by an increased demand for ammunition for the war in Vietnam and that the resulting increase in profits, from the Army contracts, of 139 percent is disproportionate and is excessive by "not less than $500,000," the amount demanded in the Government's counterclaim.

## II

### *Standards for Determining Excessive Profits*

The Act defines excessive profits as that part of the profits determined to be excessive; no rate or formula for the determination is given, other than the further provision that in determining excessive profits "favorable recognition must be given to the efficiency of the contractor," briefly elaborated to refer to quantity and quality production, reduction of costs and economies in materials, "and in addition, there shall be taken into consideration" six stated "factors" in the contractor's operations: the reasonableness of his costs and profits, his net worth, risks assumed, contribution to the defense effort, character of business and, finally, "the public interest and fair and equitable dealing." Section 103(e), 65 Stat. 9, 50 U.S.C. App. § 1213(e) (1970).[1]

No more precise standard than section 103(e) is to be found in any of the successive renegotiation acts, from the first enactment in 1942 to the last extension in June 1974.[2] The first act, indeed, contained little more than a mandate to the executive to recapture "excessive profits"; the statutory factors first appeared in the Second Renegotiation Act, in 1944.[3]

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[1] **Section 103(e) of the Act provides as follows:**

*"Excessive profits.*

"The term 'excessive profits' means the portion of the profits derived from contracts with the Departments and subcontracts which is determined in accordance with this title to be excessive. In determining excessive profits favorable recognition must be given to the efficiency of the contractor or subcontractor, with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities, and manpower; and in addition, there shall be taken into consideration the following factors:

> "(1) Reasonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products;
>
> "(2) The net worth, with particular regard to the amount and source of public and private capital employed;
>
> "(3) Extent of risk assumed, including the risk incident to reasonable pricing policies;
>
> "(4) Nature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance;
>
> "(5) Character of business, including source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting, and rate of turn-over;
>
> "(6) Such other factors the consideration of which the public interest and fair and equitable dealing may require, which factors shall be published in the regulations of the Board from time to time as adopted."

[2] Pub. L. 93–329, 88 Stat. 288 (1974).

[3] 56 Stat. 226, 245–46 (1942). An administrative directive thereupon "promptly stated the factors to be stressed in determining excessive profits" (*Lichter* v. *United States*, 334 U.S. 742, 773–74 (1948)). *Principles, Policy and Procedure To Be Followed in Renegotiation*, War Dept. Price Adjustment Board, August 10, 1942, reprinted in *Hearings Before the Subcomm. of the Senate Comm. on Finance on Sec. 403 of Pub. L. No. 528*, 77th Cong., 2d Sess. 28, 34–43 (Sept. 29 and 30, 1942).

A more detailed directive followed in 1943 which "contributed definiteness to the current administrative practice" (*Lichter* v. *United States, supra*, 334 U.S. at 778). *Joint Statement by the War, Navy and Treasury Departments and the Maritime Commission—Purposes, Principles, Policies and Interpretations Under Sec. 403 of the Sixth Supp. National Defense Appropriation Act of 1942, as Amended by Sec. 801 of the Revenue Act of 1942 (Public 753, 77th Cong.), Oct. 21, 1942,* March 31, 1943, reprinted in 2 *Hearings Before the House Comm. on Naval Affairs on H.R. Res. 30,* 78th Cong., 1st Sess. 469, 1025–39 (1943). The substance of the factors for determining excessive profits stated in the "Joint Statement" was in 1944 incorporated by Congress into the Second Renegotiation Act, and is the source of section 103(e) (note 1, *supra*) of the present Act. Section 701(b)(4)(A), Revenue Act of 1943, ch. 63, 58 Stat. 21, 78–92, 79 (1944); *Lichter* v. *United States, supra,* 334 U.S. at 783, 799.

The Supreme Court nevertheless upheld the acts and their application to contracts made prior to enactment, in an opinion which furnishes a wide-ranging guide to the purposes of statutory renegotiation, the meaning, and the standards for the determination of "excessive profits."

Congress, the Supreme Court wrote, had in adopting statutory renegotiation rejected a rigid formula for excessive profits, proposed by amendment in the House,[4] "in favor of the more flexible definition embodied in the term 'excessive profits'." *Lichter* v. *United States*, 334 U.S. 742, 773 and n. 18. "Excessive profits," the court held, "are those in excess of reasonable profits." 334 U.S. at 786, quoting from *Spaulding* v. *Douglas Aircraft Co.*, 154 F. 2d 419, 423 (C.A. 9 1946). How much profit was reasonable, and thus how much was excessive, the court concluded, is to be learned in the "purpose of the Renegotiation Act and its factual background," which "establish a sufficient meaning for 'excessive profits' as those words are used in practice." 334 U.S. at 785.[5]

From the extensive review by the Supreme Court of the factual background and purposes of the Act, it plainly appears that the premise of statutory renegotiation was that accurate pricing and the control of contractors' profits cannot be achieved during a build-up of production for defense of war. The purpose was, therefore, to control by recapture the skyrocketing profits on goods produced for war and national emergency without impeding either the volume or efficiency of that production.

The experience in World War II was that war or emergency tends to create "a demand for production of war supplies in proportions previously unimagined" and "at an undreamed of speed," whose result is unacceptably high profits, in a word, profiteering. The combination of the needed speed, the rise in demand and the all but exclusive interest of procurement officers in volume of purchases overwhelm careful cost analysis and forecasting, especially in cases of new and improved products, drawn-out negotiations and the other characteristics of sound purchasing in peacetime. As competition wanes, profits go up to levels damaging to the morale of the armed and civilian forces, excessively costly to the public treasury and productive of still further inflation in costs and profits. 334 U.S. at 763–64, 768–69.[6]

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[4] The formula rejected would have required "reimbursement of profits in excess of 6 percent" on contracts for military or naval supplies. 88 CONG. REC. 3139–140 (1942).

Limitations on profits in Government contracts to build ships and aircraft, of 10 and 12 percent, respectively, were enacted in the Vinson-Trammell Parity Act of 1934 and the Merchant Marine Acts of 1936. The present Renegotiation Act of 1951 explicitly suspends these statutes. 50 U.S.C. APP. § 1212(d) (1970).

[5] Judicial determinations of excessiveness were, the court implied, nothing new, pointing to the prohibitions of both excessive bail and fines in the Eighth Amendment to the Constitution. The reasonableness of rates, returns on investment, compensation for services, costs and depreciation allowances—all are committed by statute for decision by judges. 334 U.S. at 785–86.

The experience in World War II was not unique.[7] The same conditions, returning during the time of production for the Korean crisis, caused the enactment of the Renegotiation Act of 1951, presently being applied, H.R. REP. No. 7, 82d Cong., 1st Sess. 1–2, 2 U.S. CONG. & ADM. SERV. 1339 (1951); *see* (now Mr. Justice) R. Braucher, *Renegotiation Act of 1951*, 66 HARV. L. REV. 270, 270–80 (1952). And in 1966, shortly before the year of the profits now under review, Chairman Wilbur K. Mills of the House Ways and Means Committee advised the Congress that the enormous defense program in consequence of the war in Vietnam had resulted in such "attenuation of normal competitive forces" as required an extension for 2 years of the Renegotiation Act of 1951. The details he gave, quoted in the footnote,[8] tell essentially the same story as motivated the passage of the first renegotiation law in 1942.

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[6] Under Secretary of War Robert P. Patterson, in an affidavit sworn to on August 3, 1945, and quoted in *Lichter* v. *United States, supra,* 334 U.S. at 762 n.7, said:

"The necessary result of this combination of circumstances is that the war procuring agencies cannot use normal methods of procurement. The pressing need for speed requires the abandonment of drawn-out negotiation and the careful surveys of all relevant factors which sound purchasing would otherwise require. Competition necessarily wanes and no longer offers an adequate guide to the prices which should be paid. Above all, the forecasting of costs of production becomes, in large measure, a matter of informed guessing rather than of real cost analysis. This is true in the case of new products, new plants, and new producers; it is likewise true, though perhaps to a lesser degree, wherever the quantities to be manufactured are sharply increased over prewar amounts. Accordingly, advance prices quoted in good faith by manufacturers in a large number of cases have little relation to costs actually experienced in the course of production. * * *."

[7] High profits on goods for use in war are endemic in all periods. But they reached new heights in World War I. The 1942 Act was enacted on April 28, 1942 (56 Stat. 226, 245–46), not long after Pearl Harbor and shortly following a Supreme Court decision telling of a 22-percent profit on shipbuilding in World War I, exclusive of payments to affiliates and Government financing of plant expansion. *United States* v. *Bethlehem Steel Corp.,* 315 U.S. 289 (1942). *See* (Senator) D. I. Walsh, *War Profits and Legislative Policy,* 11 U. CHI. L. REV. 191 (1944) (quoting General Washington's bitter complaints against profiteers in 1779); H. S. Hensel & R. G. McClung, *Profit Limitation Controls Prior to the Present War,* 10 LAW & CONTEMP. PROB. 187 (1944).

Above all, the Supreme Court held in *Lichter*, "flexibility and the adaptation of the congressional policy to infinitely variable conditions constitute the essence of the program." 334 U.S. at 785. Accordingly, since 1942 the successive renegotiation acts have rejected any method, other than by application of the statutory factors, for the determination of excessive profits.

Renegotiation, so adaptable to the facts of each case, recognizes that a fair rate of profit on the manufacture of one commodity may be entirely inadequate for the manufacture of another; that even within the same industry differences among enterprises may make significant differences in the profit to be considered reasonable.[9] A fixed formula for all cases would ignore all such differences and reward the efficient, low cost producer, equally with the inefficient, high cost producer, those who contribute to the defense effort the same as those who do not.

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[8] Addressing the Committee of the Whole House in support of the extension of the Act, Chairman Mills said in part, as follows (112 CONG. REC. 13289–290 (1966):

"The central truth, as I see it, is there is simply no traditional marketplace to guide pricing for a large part of the defense and space procurement. The Navy cannot go out in the ordinary marketplace and buy a Polaris missile. NASA cannot buy commercially a Surveyor or an Apollo.

"With the elements of cost uncertainty, product complexity, and huge dollar commitments, the Government procurement market is fundamentally different in many respects and in many instances from the private competitive market. This unique set of characteristics provides the economic basis for renegotiation. Here, in summary form, are the six points I make for the necessity of the process.

* * * * *

"*First.* The bulk of Government procurement is made on the basis of negotiated prices, without market prices to guide the negotiators.

"*Second.* Price competition over a substantial part of the Government procurement market, including the successive subcontract tiers, is weak, and at times nonexistent.

"*Third.* Cost estimates are characterized by a high degree of uncertainty, particularly for new products and systems, with the result that initial prices or targets are frequently wide of the mark.

"*Fourth.* Negotiated prices are often influenced by an imbalance in negotiating skill, in favor of the industry negotiators.

"*Fifth.* Major Government contractors often work with Government plant, equipment, progress payments, and other forms of Government financing, and substantial differences exist among the contractors in the extent of subcontracting.

"*Sixth.* Government business is negotiated on a contract-by-contract basis, each contract being negotiated independently of others and without reference to the financial outcome of the other contracts. I have been told recently of one instance of a contractor holding 500 different contracts, awarded by 100 different contracting officers in 54 different procurement offices.

"In my judgment, these complex circumstances indicate our enormous defense program cannot be carried out with any assurance that the resulting profits will not exceed the bounds of fairness and reasonableness. The after-the-fact review provided by renegotiation is essential to fill the void left by the attenuation of normal competitive forces."

The statutory factors, on the other hand, provide for all the possible differences in cases—the character of the business, its efficiency, the contribution to the defense effort, the net worth and capital employed, the risks assumed, the reasonableness of costs and profits and any others required to do equity and serve the public interest. No single fact or factor is determinative. All the facts must be taken into account, all the statutory factors considered.[10] The consideration given each statutory factor must be weighed with the others specified and with any other factors required by the public interest and the principles of fair and equitable dealing. Note 1, *supra.*

## III

### *Character of Business*

Though near last in the list of factors in section 103(e) (note 1, *supra*), the character of the contractor's business is considered first, as a setting for the application of all the factors.

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[9] "* * * Even within the same industry a company with a new modern plant, fitted out with new machinery, arranged with a view to the most economical production, and all provided by the government, is not entitled to the same rate of profit as one that produces the same articles in an old plant, perhaps not designed in accordance with the latest ideas for the most efficient production, but all provided by the contractor without government aid. * * *." C. G. Blough, *Renegotiation Standards and Practices,* 10 LAW & CONTEMP. PROB. 276, 295 (1944).

[10] The regulations of the Board, unchanged in this respect since adopted in 1952, provide that (17 Fed. Reg. 2530 (March 25, 1952), 32 C.F.R. § 1460.8(a) (1973)):

"Reasonable profits will be determined in every case by over-all evaluation of the particular factors present and not by the application of any fixed formula with respect to rate of profit, or otherwise. Renegotiation proceedings will not result in a profit based on the principle of a percentage of cost. Contractors who sell at lower prices and produce at lower costs through good management, including conservation of manpower, facilities and materials, improved methods of production, close control of expenditures, and careful purchasing will receive a more favorable determination than those who do not. Such favorable or unfavorable determination will be reflected in the profits allowed to be retained by the contractor or subcontractor as nonexcessive. * * *."

Plaintiff's earlier work of designing and building ammunition plants for the Government led to its undertaking the operation of the four GOCO plants which became substantially its sole business. The Army's GOCO ammunition plants were the response to the need for a production capacity ample for defense or war. The creation of the needed capacity required larger amounts of capital than private industry was willing to invest in a business which enjoyed doubtful public approval and would be subject to a sharply fluctuating demand for its products. Accordingly, before and during World War II the Government embarked on a program of building such plants at public cost. At the end of World War II there were 84 GOCO plants in existence.

GOCO plants continued to be built and operated during the Korean and Vietnamese wars, and since.[11] In 1967 there were 34 GOCO ammunition plants operated for the Department of Defense, 26 of them for the Army Procurement and Supply Agency. Among the latter were the two conventional ammunition plants operated by the plaintiff.

AEC-owned GOCO plants date from the earliest days of nuclear weapon production, when both public and private efforts were joined for the development of the nuclear bomb. Under successive atomic energy acts, the AEC has since developed the concept of a management contract for operation of AEC-owned facilities, exemplified in the contracts for the two AEC plants operated by plaintiff, under which a single fee is paid, annually, for the operation of the facility. See O. S. Hiestand, Jr., and M. J. Florsheim, *The AEC Management Contract Concept*, 29 FED. BAR J. 67, 69–70 (1969).

In 1967 the AEC owned a wide variety of technical service and manufacturing facilities operated for it by 40 prime contractors employing over 106,000 persons. Of these facilities 26, among them the two plants presently under consideration, represented investments in excess of $25 million each. *Annual Report to Congress of the Atomic Energy Production Commission for 1967*, 281, 317–21.

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[11] A Government-owned "national reserve of industrial productive capacity" to supply the needs of the armed forces in anticipation of and during wartime was provided for in the National Industrial Reserve Act of 1948, ch. 811, 62 Stat. 1225. 50 U.S.C. §§ 451–62 (1970).

The work at the two AEC plants operated by plaintiff consisted primarily of the assembly of nuclear weapons from high explosives produced at the plants and combined with nuclear, firing and fusing components and casings furnished by the Government or purchased from other GOCO or private plants; in addition, 20 percent of the work consisted of the maintenance and testing of stockpiled nuclear weapons; and 10 percent was research and development.

The work of the two Army plants, called Cornhusker and Iowa, is the loading, packing and assembly of 500-, 750-, 1,000- and 2,000-pound bombs, large caliber artillery projectiles and aerial antipersonnel mines, at Cornhusker, and of projectiles of various lesser calibers ranging from 76 to 175 mm. and a variety of such items as warheads, igniters, grenades and mines at the Iowa plant. As in the AEC plants, high explosives are formulated at the plants and casings and other components are supplied.

The Cornhusker plant was, in 1967, the only producer of the 750-pound bomb and an antipersonnel aerial mine containing a particularly sensitive explosive. Nine million of these mines were produced under a program newly begun in that year.

The four plants are a vast enterprise. The Iowa Army plant and one of the AEC plants together occupy a tract of 19,136 acres near Burlington, Iowa, with 150 miles of road, 102 miles of railroad, and 1,042 buildings housing 4 million square feet of floor space. The other AEC plant, near Amarillo, Texas, occupies 10,200 acres and 80 buildings with 700,000 square feet of floor space. The Cornhusker Army plant, at Grand Island, Nebraska, occupies almost 12,000 acres and 649 buildings with 2.3 million square feet of space. In 1967 the work force at the four plants averaged 11,193 persons; the 363 professional employees included 151 engineers, divided among civil, mechanical, electrical, chemical and industrial and quality control, 33 chemists and biologists and 32 physicists and mathematicians.

The estimated replacement value of the Iowa Army plant is $66 million; that of the Cornhusker plant is $31.5 million. Each of the AEC plants, as noted, represents an investment "in excess of" $25 million.

The contracts of the AEC and the DOD plants, while all of the cost-plus-fixed-fee type, are significantly different. "AEC has a different view of its GOCO operations than DOD and calls them 'management contractors'." 1 Report of the Commission on Government Procurement 66 (1972). For the management of both AEC plants plaintiff in 1967 was paid a single annual fixed fee of $864,000 plus $16,640 as a fixed fee for additional construction at one of the plants, a total of $880,640. The basic contracts for the operation by plaintiff of the Army plants do not provide for a fee. Orders are placed for particular items of ammunition on the basis of estimates of cost and are then added to the contract by amendment. Each such amendment provides for an agreed fixed fee per unit of ammunition produced, called a unit production fee. For each 175-mm. shell produced, for instance, plaintiff was paid $0.27. One of the contracts, for the Cornhusker plant, also provides for an award fee for superior performance, payable in the discretion of APSA.

All costs, with an exception noted below, are borne by the Government or defrayed by the supply of materials used or equipment needed. Costs at the AEC plants are prefinanced by a letter of credit against which plaintiff draws. At the Army plants, costs are reimbursed promptly after expenditures, within the week, although the contract requires reimbursement only monthly. Fees are paid promptly. Plaintiff is thus enabled to operate with a very small amount of working capital at the plants. Plaintiff's surplus, total assets and net worth are $5.7 million, $6.3 million and $6.0 million, respectively.

The only cost which is not reimbursed is the cost of plaintiff's corporate overhead at its home office. The home office is headed by a chairman, president, and executive vice-president, who own 88 percent of the outstanding stock of the plaintiff corporation and are paid total salaries of $225,000. No question has been raised as to the reasonableness of salaries paid by plaintiff.

The four plant managers report to the chief engineer and vice-president in charge of operations, an officer other than the executive vice-president. The functions of the home office are overall supervision of plant managers, the negotiation of

Government and labor contracts, the formulation of corporate policy, and the provision of services for the guidance of the four plants in areas of labor relations and safety. The costs of the home office and other nonreimbursable corporate costs (chargeable to plaintiff's renegotiable contracts) in 1967 amounted to $822,000 and were absorbed by plaintiff's fixed fees. The renegotiable profit of $2,681,800 mentioned above is net after nonreimbursable costs.[12]

Specifically mentioned in the statutory statement of the factor of "character of business" are the "source and nature of materials, complexity of manufacturing technique, character and extent of subcontracting and rate of turn-over." Sec. 103(e)(5), note 1, *supra*. Calculation of a rate of turnover is not warranted by the state of the record and the nature of plaintiff's business; each of the other aspects of plaintiff's business will be briefly considered.

a. *Source and nature of materials*. The "nature" of the materials used at the plants is noteworthy; large quantities of high explosives are components of the ammunition loaded by plaintiff. So far as the record shows, materials otherwise present no problems for plaintiff. Materials are either supplied to plaintiff directly by the Government or obtained from other GOCO or private contractors. While the record contains little data on the point, it may be assumed that the Government assured plaintiff of adequate supplies of bomb casings, atomic warheads and the materials necessary for the fabrication of the high explosives to be loaded.

The regulations of the Renegotiation Board provide that the contractor who uses customer-furnished materials generally is not entitled to as large a dollar profit as the dollar profit to which such contractor would have been entitled had it furnished the materials itself. 32 C.F.R. § 1460.14(b)(2) (1973), hereafter cited as "Regulations."[13] The contractor who furnishes his own materials, the regulation notes, has "expended effort in finding or acquiring the materials, would have invested capital in the materials and would have assumed the risks of obsolescence, spoilage, or other loss inherent in owning such materials." Plaintiff has in all likelihood not expended such effort, and it has not made such investment or assumed such risks.

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[12] Taxes, it may be mentioned, play no part in this proceeding. The renegotiable profit is to be passed upon herein for excessiveness without consideration of taxes already paid on such profits. Determinations of excessive profits, if any, are made on profits before taxes, and judgments are credited for taxes already paid. 50 U.S.C. APP. § 1215(b)(8) (1970); INT. REV. CODE of 1954, § 1481(b); 26 U.S.C. § 1481(b) (1970).

[13] The regulations of the Renegotiation Board under the Renegotiation Act of 1951, found in Title 32 of the Code of Federal Regulations at § 1450 *et seq.*, were adopted pursuant to authority conferred in section 109 of the Act, 50 U.S.C. APP. § 1219 (1970). The regulations cited and relied upon herein reason-

b. *Character and extent of subcontracting.* Plaintiff did not subcontract any of the work at the AEC plants; at the Army plants, subcontracting was minimal and was estimated at 5 percent or less. The work at both the plants is in the main delicate and complex, and the amount of possible subcontracting was no doubt a function of the work and closely controlled by the contracting agencies.

c. *Complexity of manufacturing technique.* "The manufacturing contribution will vary with the nature of the product and the degree of skill and precision required in the work performed by the contractor. The relative complexity of the manufacturing technique and the relative integration of the manufacturing process are the basic considerations in evaluating this factor." Regulations, § 1460.14(b)(1).

It is abundantly clear that the manufacturing techniques employed in the four plants are highly complex, the products must meet high standards, and that plaintiff adds great value to the materials used. Plaintiff is deserving of favorable consideration for its substantial manufacturing contribution, which will be further discussed with, and treated as part of, the factor of its efficiency.

## IV

### *Efficiency*

Efficiency is the only factor for which "favorable" recognition *must* be given; all the other factors are to "be taken into

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ably elaborate themes immanent in the statute itself, and it is therefore not necessary to decide whether they are binding, in this de novo determination, to the extent other regulations would be on judicial review of agency action. *Compare Albemarle Paper Mfg. Co.* v. *Renegotiation Bd.*, 35 T.C. 438, 443 (1960), and *Metallurgical, Inc.* v. *Renegotiation Bd.*, 35 P–H Tax Ct. Mem. 66,687 at 66,693, ¶66,114 (1966), *petition for rev. dismissed*, 382 F. 2d 843 (C.A. 8 1967), with *Spray Cotton Mills* v. *Secretary of War*, 9 T.C. 824, 830 (1947), and *Psaty & Fuhrman, Inc.* v. *Henry L. Stimson*, 11 T.C. 638, 643 (1948), *petition for rev. dismissed*, 182 F. 2d 985 (C.A. D.C. 1950).

consideration." Sec. 103(e), note 1, *supra*. Special emphasis, therefore, is given to efficiency, by both the Renegotiation Board and the courts. *North Am. Aviation, Inc.* v. *Renegotiation Bd.*, 39 T.C. 207, 226 (1962); *cf. Boeing Co.* v. *Renegotiation Bd.*, 37 T.C. 613, 631–41 (1962), *petition for rev. dismissed*, 325 F. 2d 885 (C.A. 9 1963), *cert. denied*, 377 U.S. 923 (1964).

The overall judgment of the reporting agencies on plaintiff's efficiency was highly approving.

The AEC's renegotiation affairs officer reported that "there has been a continued improvement in services and performance of work" and that plaintiff's "performance record in 1967 was considered satisfactory and the overall objective (including that of economics [sic] performance) had been achieved." The general manager of the AEC wrote to the Board that plaintiff had "performed an outstanding management service" and had made contributions "exceptionally important in the manufacturing of a better quality product."

The APSA report on the Iowa plant stated that "[t]he contractor's overall performance for the period under consideration has been most satisfactory." For the Cornhusker plant, the report was that "performance from a production viewpoint has been very good." At that plant, plaintiff received an award fee of $53,449, payable in APSA's discretion; the amount represents 30.3 percent of the potential maximum of such fees.

a. "*Quantity * * * production.*" Sec. 103(e), note 1, *supra*. Quantity production is in the regulations related to "available physical facilities; meeting of production schedules; expansion of facilities; maximum use of available production facilities." Regulations, § 1460.9(b)(1).

The level of production at the plants was high in relation to physical facilities. The APSA report on the Cornhusker Army plant states that "[i]n 1967, as a result of the war in Southeast Asia, Cornhusker AAP was operating at full capacity."

The report on quantity production at the Iowa Army plant is as follows:

> *Level of Production:* Loading, assembly, packing (LAP) operations in the calendar year involved the

> production of 40 to 45 different items, many of them new items. Nine of the 11 lines were in operation for 2 months of the year and 10 of the 11 lines operated for the other 10 months. Most of the lines were operating on a two to three shift basis. In addition to the support activities, routine maintenance work, facilities expansion and reactivation of production lines performed by the contractor, the design, fabrication and procurement of loading and assembly equipment for new items was at a very high level.

b. *Production schedules.* At the Cornhusker Army plant "[d]elivery schedules were met although frequent changes were made by the Government with little advance notification." At the Iowa Army plant delivery schedules "were generally met"; the instances of failure were a result of non-availability of Government-furnished metal parts.

c. *Expansion of facilities and maximum use of production facilities.* In the period of less than 2 years between the latter part of 1965 and the end of 1967, plaintiff brought the Cornhusker plant from a "mothballed" status to "full capacity" and the Iowa Army plant from a "low, sustaining basis" to a "very high level." The Army authorities were apparently completely satisfied with the rate of expansion of facilities brought about by plaintiff and the rate of use in 1967.

d. *Quality production.* Section 103(e), note 1, *supra.* Three areas relevant to consideration of quality production, given in the regulations, are maintenance of standards of quality, rejection record, and difficulties in the use of installation of the product. Regulations, § 1460.9(b)(2).

There is no evidence of any difficulties in the use of the product in the field suggestive of any lack of quality of the products of the plants. The evidence as to maintenance of quality standards and rejection record is affirmatively favorable to plaintiff. The APSA reports state:

At Cornhusker:

> Rejection and spoilage rates are considered low.

At Iowa:

> Rejection and spoilage rates were kept to a reasonable and acceptable level. The introduction of new items and extremely rapid expansion of production schedules with the inherent increase in training of personnel, defective

> metal parts and numerous changes in specifications, caused an increase in spoilage rates.

Labor relations, recruitment efforts and personnel policies were good:

> At Cornhusker:
>
> There have been no strikes, stoppages, or other significant developments in labor management affecting contractor performance.
>
> At Iowa:
>
> Contracts were negotiated with all unions during 1966 for a period of 3 years. There were no strikes or work stoppages during the period of this report. Joint labor-management meetings were held monthly to discuss problems that had arisen thus providing a continuous channel of communication. Difficulties have been experienced in the recruitment of personnel due to the rapid buildup of production and production schedules and tight labor market. However, contract performance has not been affected to any substantial degree in this area.

e. *Reduction of costs, and economy in the use of materials, facilities, and manpower.* "Costs" of the contractor are mentioned twice in the statutory factors, once under the factor of efficiency, in the phrase "reduction of costs, and economy in the use of materials, facilities, and manpower," and again in the statement of the factor of "reasonableness of costs and profits." Sec. 103(e), note 1, *supra.*

Plaintiff incurs two kinds of costs—its own costs of corporate overhead, not reimbursed by the Government, and the operational costs of production, all reimbursed to it. It will be both convenient and responsive to the differing emphasis in the two uses of the word "costs" to allot the reimbursed costs to the discussion, here, of "reduction of costs," and to reserve discussion of plaintiff's nonreimbursed costs for the treatment, below, of the "reasonableness of costs and profits."

Cost savings by plaintiff were reported as follows:

> The report by the general manager of the AEC:
>
> During this period, Mason & Hanger-Burlington effected cost reductions in the amount of $570,400 of which $55,600 was applicable to the first half and $514,800 was applicable to the second half of the year. During the same year, the Pantex plant effected cost re-

> ductions in the amount of $1,158,000 of which $831,000 was applicable to the first half and $327,000 was applicable to the second half of the year. These cost savings have been verified by the AEC as actual cost savings for the period.

The APSA report on Cornhusker:

> Through Value Engineering, a new and improved method of coating the interior of bomb casings was developed and put into use as well as other developments to improve melt loading techniques.

The APSA report on the Iowa plant:

> [The contractor] has made effective use of Value Engineering validated cost reduction savings in the amount of $275,700.00 for calendar year 1967.

Matters relating to economies in materials are discussed in the APSA report on Cornhusker:

> The contractor is considered average in controlling the use of materials, facilities, manpower and production costs.
>
> The adequacy and reliability of the contractor-provided cost information has been average to above average compared to other COGO contractors.
>
> The contractor is an average cost producer. Contract costs are based on product unit cost estimates submitted by the contractor and reviewed by the Government. Revised estimates are prepared whenever a fund deficiency or excess funding is indicated and the contract amount is adjusted accordingly. Upward revisions have generally been due to schedule changes and/or slippages in Government-furnished components.

The report on the Iowa plant states:

> The contractor has utilized materials, facilities, and manpower in a satisfactory and economical manner and has been reasonably effective in controlling production costs.
>
> The adequacy and reliability of the contractor-provided cost information has been average to above average compared to other GOCO contractors.
>
> The contractor is an average cost producer. Cost overruns were caused in most instances by unforeseen problem areas, primarily new items and additional work and changes in specifications after the original estimates and funding were provided. Cost underruns were caused primarily by rapid increase in the volume of production

> and the resulting decrease of overhead applied. This factor is involved in both underruns and overruns since the overhead fluctuates with the volume of production. Another cause for overruns and underruns is inaccurate estimates for the new items for which no prior experience or historical data is available.

The less than high praise in these last-quoted opinions—that plaintiff was "average to above average" and "reasonably effective" in this area—does not lessen what is otherwise a high mark for efficiency. The relationship of cost estimates to actual costs is not necessarily significant in determining efficiency. Regulations, § 1460.9(b)(5)(*b*). Such cost overruns and underruns as occurred, it appears, were for causes not the fault of the plaintiff. In wartime, "average to above average" control of costs of materials may be a substantial achievement. Materials incorporated into the ammunition produced at Iowa and Cornhusker, moreover, were in all likelihood available only at prices not within plaintiff's control.

The overall conclusion as to the factor of efficiency is that plaintiff is entitled to favorable recognition for a high degree of efficiency.

## V

### *Contribution to the Defense Effort*

Section 103(e)(4), note 1, *supra*, calls for consideration of the—

> [n]ature and extent of contribution to the defense effort, including inventive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance.

The APSA report on the Iowa plant states that the contractor made a contribution to the defense effort "by virtue of his operation of this plant by producing acceptable ammunition and ammunition components for the Armed Forces." The contractor who performs a defense contract does not by that token make a contribution within the meaning of the Renegotiation Act. Favorable consideration is rather due a contractor for "superior performance" or "performance, assistance or service considered otherwise exceptional"; illustrations are "completion of urgent work ahead of schedule, or exceeding specifications" with benefit to the defense effort, "ingenuity in providing new uses" for products or equipment, "overcoming difficulties, which others have failed to overcome," or "experimental and developmental work of value to the defense effort," "new inventions, techniques, and processes of unusual merit," work under difficult or hazardous conditions, cooperation with the Government and with other contractors. Regulations, § 1460.13(b).[14]

a. *Inventive and developmental contribution.* At the Cornhusker plant, as is shown in the quotations, above, from the APSA reports, plaintiff developed improved techniques for melt-loading ammunition and for coating bomb casing interiors. The APSA report on the Iowa plant implied that contributions were made at that plant also; the report speaks of Value Engineering cost savings and, also, states that "the design, fabrication and procurement of loading and assembly equipment for new items was at a very high level."

The renegotiation affairs officer of the AEC who is quoted above reported to the Renegotiation Board that "the contractor did not make an outstanding contribution to the defense effort in 1967." The foregoing opinion, under date of October 15, 1968, was contradicted, with supporting detail, in a second letter, from the general manager of the AEC to the Board on April 8, 1970, written apparently when plaintiff's profits for 1967 were under review by the Board at a high level.

The general manager stated that he wrote to advise the Board of "areas in which credit should be given to [plaintiff] for production engineering and related activities." The plaintiff, he said, has a high degree of expertise, some of which "pushes the state-of-the-art" and is not available elsewhere except in the AEC's design laboratories, consisting of

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[14] The text summarizes a detailed regulation on the subject of contribution to the defense effort adopted by the Renegotiation Board in 1973 to express more specifically the need for exceptional contribution as distinguished from routine contribution. 38 Fed. Reg. 6390, March 6, 1973. The former regulation, in force from 1960 to 1973, stated, more briefly, that "[f]avorable consideration for unusual contributions will be possible only when the contribution is exceptional," and gave as examples experimental and developmental work of high value, new inventions of unusual merit and cooperation with the Government. 32 C.F.R. § 1460.13(b) (1967).

"scientific and engineering knowledge and know-how in the various technologies associated with the fabrication of high explosive parts and assembly of nuclear weapons." This expertise, he continued, was relied upon by the AEC for the development of techniques and manufacture of equipment to meet the specifications produced in AEC laboratories. He enclosed a list of examples illustrating his conclusion that plaintiff's "ideas, suggested changes and development of processing techniques * * * [have] been exceptionally important in the manufacturing of a better quality product."

The opinion of the general manager is not challenged by the Government as defendant, and is here accepted as an expert and authoritative affirmation of the plaintiff's inventive and developmental contribution to the defense effort. The letter, so far as it goes, must be taken, too, as a reconsideration and retraction of the earlier judgment that plaintiff did not make an outstanding contribution to the defense effort.

On the basis of the reports from APSA and the general manager's letter, plaintiff is entitled to favorable consideration, in the words of the regulation, for "experimental and developmental work of high value to the defense effort," if not also for "new inventions, techniques, and processes of unusual merit." Regulations, § 1460.13(b).

b. *Cooperation with the Government and other contractors.* It may be doubted whether a contractor whose costs are being paid by the Government deserves special consideration for cooperation with the Government. In fact, however, plaintiff did cooperate with other GOCO contractors and with several foreign governments, rendering technical assistance or advice in connection with ammunition production.

c. *Work under difficult and hazardous conditions.* Plaintiff's work, involving the handling of large quantities of high explosives, is necessarily dangerous. There is inevitable, constant risk of explosion, despite all training programs and accumulated experience in safety techniques. Plaintiff's personnel, however, not its corporate treasury, bears the risks. The financial risk, as is held below in the discussion of the statutory factor of extent of risk assumed, is borne by the Government.

Nevertheless, without detraction from the principle that only exceptional contributions are recognized favorably, a substantial contribution to the defense effort is made by an organization whose several thousand members constantly work with large quantities of high explosives, producing, at rapidly increasing and near full capacity, "major caliber" projectiles, bombs and mines in large numbers, among them new and developmental items, and in this work perform in a "most satisfactory" and "very good" manner. As the Tax Court has said, the contemplated "contribution" includes "not only services performed without compensation, but the cooperative and enthusiastic performance of that work, and, in addition, the importance of the product produced and the services rendered, even though paid for, to the defense of this country." *Boeing Co.* v. *Renegotiation Bd.*, *supra*, 37 T.C. at 645.

It is therefore concluded that plaintiff made a contribution to the defense effort in this area, too.

Overall, it is plain, plaintiff made a substantial contribution to the defense effort, for which it is entitled to favorable consideration.

## VI

### *Extent of Risk Assumed*

This factor includes the "risk incident to reasonable pricing policies." Sec. 103(e)(3), note 1, *supra*. The regulations speak, in addition, of such other risks as guarantees of quality or of delivery schedules, risks of loss of civilian markets or of heavy reconversion expenses and risks from subcontracting. Regulations, § 1460.12. None of these risks is taken by the plaintiff in its business, in any appreciable degree.

Risk may be a major factor in competitively bid contracts where the contractor usually binds himself to sell, at a fixed price, goods yet to be produced from materials or sources which have not been used before. In cost-plus contracts such as are here involved, however, such risks are not present. The performance reports from both APSA and the AEC agreed that plaintiff assumed no risk in the performance of its contracts. APSA contracted with plaintiff on the assumption that plaintiff bore no risk.

Risk is practically eliminated in GOCO contracting. The Government supplies and risks the capital. None of the "sales" of the GOCO contractor is made at a fixed price; costs are reimbursed and profit margins assured. The Government arranges for the supply of components and bomb casings, and risks associated with procurement of materials are not present and in any event the financial consequences of such possibilities are assumed by the Government. There is no risk when capital is supplied and substantially all costs are paid by the Government. *Cf. North Am. Aviation, Inc.* v. *Renegotiation Bd., supra*, 39 T.C. at 229; *Boeing Co.* v. *Renegotiation Bd., supra*, 37 T.C. at 643.

Some risks of losses other than those mentioned above are alleged by plaintiff to have affected its capital needs; these are discussed in connection with the net worth factor, immediately following. Still other, miscellaneous risks allegedly assumed were insubstantial. A claimed risk of strikes, for instance, upon which the plaintiff's work would be given to another GOCO plant, was in fact negligible in 1967 and to the extent it existed it was a risk only of the loss of profits such as comes on a termination of the contract.

Plaintiff is not entitled to favorable consideration by reason of risks assumed.

## VII

### *Net Worth*

The second numbered statutory factor in section 103(e)(2) (note 1, *supra*), is—

> [t]he net worth, with particular regard to the amount and source of public and private capital employed; * * *.

The plants operated by plaintiff were built by the Government. All equipment was supplied, large portions of the materials used for the finished product were furnished, and the costs of the remainder—indeed, all costs except $822,000 of plaintiff's corporate overhead and home office—were borne by the Government.

Reimbursement by the Government of costs was exceedingly prompt. The AEC prefinanced costs by providing a letter of credit against which plaintiff drew as it needed money to pay salaries and bills. The Army, bound by contract to make reimbursement at monthly intervals, actually reimbursed plaintiff weekly, concurrently with the release of plaintiff's checks, so that plaintiff did not draw on its own money. Plaintiff was thereby able to operate with a total of $40,000 in working capital at the Army plants.

Plaintiff's capital needs were limited to the mentioned working capital and the approximately $822,000 cost of corporate overhead not reimbursed as a cost. Only a fraction of this latter sum was ever tied up for long, because the fixed fees which defrayed the overhead and provided profits were paid promptly. Capital needs for operation of the four plants were negligible.

The system of cost-reimbursement was so prompt, and the payment of fixed fees so frequent, that plaintiff was not required to use substantial amounts of its own funds for extended periods of time, and may not expect favorable consideration under this factor. Such ratios as turn-over of capital, net worth to sales and rate of return on capital employer are irrelevant.

a. *Capitalization of know-how.* Plaintiff urges that its "know-how" be treated as an asset and the substantial value thereof be added to the capital devoted to the business.

Plaintiff relies on *North Am. Aviation, Inc.* v. *Renegotiation Bd., supra*, 39 T.C. at 228–29, and *Boeing Co.* v. *Renegotiation Bd., supra*, 37 T.C. at 635–36. *See also Offner Products Corp.* v. *Renegotiation Bd.*, 50 T.C. 856, 863 (1968); *X-Ray, Inc.* v. *Renegotiation Bd.*, 28 P-H TAX CT. MEM. 459, 465, 7 CCF ¶ 71, 117 (1959). In the cited cases the contractor had contributed relatively small amounts of capital which by the use of know-how and expertise were made unusually productive. The Tax Court accordingly recognized know-how as a capital asset, as a means of calculating proper compensation or allowable profits. A. E. Burns, *The Tax Court and Profit Renegotiation*, 13 J. LAW & ECONOMICS, 307, 316 *et seq.* (1970).

In the instant case, however, plaintiff contributed no capital to the enterprise, and, moreover, all the know-how in question was obtained at the cost of the Government. In all the years in which the plaintiff operated these plants, the

Government bore the cost of the development of the recruitment and training skills, the innovations and improvements—the accumulation of all the experience which was the source of the know-how and expertise now said to be a capital asset of the plaintiff, to be added to its capital contributed. On such facts it is inappropriate to capitalize "know-how." The products of "public capital" should not be converted to "private capital." Here it is appropriate to give the words "net worth" and "private capital," in the statute and in the regulations, their normal meaning of the kind of net worth and capital found in balance sheets, consisting of money and assets of the owners actually invested in the business for productive use. Sec. 103(e)(2), note 1, *supra;* Regulations, § 1460.11. The skill of plaintiff's personnel and the other facets of plaintiff's know-how will get the recognition they richly deserve under the factors of "efficiency" and "contribution to the defense effort." To treat them in addition as capital would double their weight.

Finally, there is no basis in the record on which a capitalization of "know-how" could be based. In at least one case, the Tax Court found itself unable to value the know-how of a company for lack of relevant data in a record before it. *LTV Aerospace Corp.* v. *Renegotiation Bd.*, 51 T.C. 369, 405–06 (1968). The record in this case is equally barren of data on which the plaintiff's substantial know-how could be capitalized.

b. Plaintiff claims that it was exposed to several risks of losses which required that it maintain a substantial part of its surplus of over $5 million as a reserve, and thus that it actually devoted large parts of its capital to the needs of its business. None of these arguments has merit.

The financial risk from possible loss of the very substantial values in Government-furnished property entrusted to plaintiff was negligible. No appreciable losses on this account, nonreimbursed, were shown to have been suffered. Plaintiff was by contract indemnified for any such loss, excepting only losses caused by misconduct of top management.

There was no financial risk from the possibility that reimbursement might be made by the Army at less frequent intervals than weekly, thereby requiring that plaintiff maintain large amounts of working capital at the plants. The Army recognized that plaintiff must be compensated for the use of any additional capital, and were a different schedule of reimbursement to be adopted, it would be accompanied by such additional compensation as would defray the cost of the additional capital. Indeed, this is what occurred, in 1972.

Another risk contended for is based on the hazardous nature of the business—the risk of explosion of the large quantities of high explosives which are extensively handled. While the risk is presumably minimized by plaintiff's high degree of expertise and the safety programs it puts into effect, the personnel at work in the plants is nevertheless subject to an irreducible risk. But the financial risk is the Government's.

The Army by contract explicitly assumed the financial consequences of explosion. The AEC by contract undertook to bear the nuclear risk, up to $500 million in the United States and up to $100 million outside the United States. While the AEC was reluctant in 1967, to explore the possibility of insurance for the nonnuclear risk of explosion, it undertook to cover all "just and reasonable costs." Plaintiff was therefore reasonably justified in relying on Government responsibility for the costs of any explosion. Plaintiff has not borne any but inconsequential costs from explosions since it first began operation of these plants in 1958.

A last risk said to require maintenance of reserves was the risk of termination for the convenience of the Government, upon which plaintiff might need its capital to re-enter other business. This is neither a true risk nor among the risks to be considered under the statutory factors. Termination for the Government's convenience, in a cost-plus ammunition plant where orders are placed for lots of ammunition as needed, is not very different from termination by full performance. When ammunition is no longer needed, orders will cease to be placed. In any event, plaintiff was free to use its capital and surplus to enter any business it desired or to return to its former business, which it abandoned because of diminishing profit possibilities.

c. The regulations provide that where the capital employed is the Government's, the contractor's contribution becomes "one of management only." Regulations, § 1460.11(b).[15] The principle embodied in the foregoing regulation was approved in *Boeing Co.* v. *Renegotiation Bd., supra*, where a great preponderance of Boeing's facilities and production equipment were Government-furnished. The court held that "petitioner's profits cannot be viewed in the same light as those of a manufacturer which in performing a Government contract furnishes all or a major proportion of the manufacturing facilities used." Boeing's "function," the court held, "was * * * to some extent that of a manager and not a manufacturer." 37 T.C. at 644.

In a second case dealing with a similar situation, the Tax Court said that "a contractor which uses its own assets is entitled to an element of return equivalent to the rental value of the assets, a contractor using the assets of others is not." Also, that a contractor who relies heavily on Government-owned property "is primarily a manager," and "is not entitled to as large an absolute amount of profit as a contractor using its own property." *LTV Aerospace Corp.* v. *Renegotiation Bd., supra*, 51 T.C. at 405.

The view of plaintiff's services as that of a manager or operator need not preclude a fair profit, which will make full compensation for all the services performed, whether described as plant management, maintenance or operation, mobilization of the Government's resources, recruitment and training, or even the manufacture of ammunition. This plaintiff is not, of course, a mere plant manager, who even if he managed four plants might be entitled only to the equivalent of a generous salary and fringe benefits. The proper wages of the management provided by plaintiff must include the compensation due an entrepreneur, but not the capital supplier.[16] Plaintiff is an entrepreneur who provided the total services of operations of four plants, including bringing two of them up to full production and such development, innovation and maintenance work as was required. The services were a productive mobilization and use of exceedingly large assets and plaintiff is entitled to compensation with a view to the amount of assets mobilized and made productive, regardless of their source, if not to a return on capital supplied by others. *LTV Aerospace Corp.* v. *Renegotiation Bd.*, *supra*, 51 T.C. at 405. It should, however, be understood that the production or manufacture involved is not of the ordinary kind, performed by an entrepreneur, who having furnished his own capital and borne his own costs, and sold the product, is entitled to all the elements of the profit due the capital supplier—rental or return for the use of the capital, compensation for the risk of loss and even sums needed for new economic growth.

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[15] The regulation provides (Regulations, § 1460.11(b)):

"(3) Capital employed is the total of net worth, debt, and any assets furnished by the Government or customers not contained in the contractor's records. The source of capital will be established in order that a determination may be made of the extent to which capital employed in renegotiable business came from public sources or from customers, or was furnished by the contractor.

"(4) The relationship of profit realized on renegotiable business to the capital and net worth employed in renegotiable business will be used as one of the considerations in the final determination of what constitutes excessive profits. A contractor who is not dependent upon Government or customer financing of any type is entitled to more favorable consideration than a contractor who is largely dependent upon these sources of capital. *When a large part of the capital employed is supplied by the Government or by customers, the contractor's contribution tends to become one of management only and the profit will be considered accordingly.*" [Emphasis added.]

In a word, plaintiff cannot expect a return on capital it has not employed or contributed. The level of its compensation cannot be judged by those standards which automatically come to mind for enterprises which supply their own capital needs.

## VIII

### *Reasonableness of Costs and Profits*

The distinction made earlier (see p. 17) between costs borne by the Government, on the one hand, and plaintiff's home office overhead costs for which plaintiff was not reimbursed, on the other, bears repeating here. The reduction in costs borne by the Government, as a result of plaintiff's efficiency, is taken into account under the statutory factor of "efficiency." In now evaluating the reasonableness of costs and profits, we are concerned with plaintiff's own nonreimbursed costs, *i.e.*, home office overhead.

Section 103(e)(1) of the statute directs that in determining excessive profits, if any, there is to be considered the

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[16] B. S. Kierstead, *Profit*, in 12 INTERNATIONAL ENCYCLOPAEDIA OF SOCIAL SCIENCES 547, 548 (1968).

"[r]easonableness of costs and profits, with particular regard to volume of production, normal earnings, and comparison of war and peacetime products." The regulations, § 1460.10(b)(1), state that "[c]omparisons will be made with the contractor's own costs and profits in previous years and with current costs and profits of other contractors, if such information is available."

The record contains evidence permitting both comparisons set out in the regulation. We first consider plaintiff's 1967 costs and profits with relation to its costs and profits in previous normal or peacetime years. Subsequently, we will compare plaintiff's costs and profits in 1967 with those of other GOCO contractors in that year.

From 1962 through 1965 plaintiff's gross income from sales was stable at a level of about $40 million. The actual figures are as follows:

| | |
|---|---|
| 1962 | $41, 282, 276. 45 |
| 1963 | 39, 445, 883. 91 |
| 1964 | 40, 748, 260. 31 |
| 1965 | 39, 503, 465. 09 |

All but a small percentage of that income was derived from sales in the four GOCO plants operated by plaintiff.[17] We know that in 1965 the Iowa ammunition plant was operating at a relatively low production level, with seven of the maximum 11 production lines in use.[18] The Cornhusker plant was not engaged in production at all, with plaintiff's only fee a small one for maintenance of the plant in the "mothballed" state. Plaintiff was, of course, receiving fees for its management of the AEC plants in 1965.

When American participation in the war in Vietnam intensified, beginning in late 1965, the need for ammunition increased correspondingly, and production at the two Army plants operated by plaintiff increased sharply. Cornhusker was activated, and production at both plants steadily enlarged. The labor force was doubled in each of the years 1966 and 1967, to the point where in 1967 Cornhusker was operating at full capacity, and Iowa was, during most of 1967, producing at "a very high level," with 10 of 11 production lines operating, most of them on a two- or three-shift basis.

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[17] The record shows that since 1958 plaintiff has been engaged almost entirely in the management of the four plants. The record also shows that in 1965, $39,041,000 of the $39,503,465.09 was renegotiable receipts.

[18] The record does not show whether there was more than one shift per day.

The increase in production was directly mirrored in the rise in plaintiff's sales (receipts), which consist of its reimbursable costs plus fixed fees per unit.[19] The rise in receipts, and in addition the rise in profits, and profits expressed as a percentage of receipts, are depicted in the following table:

| | *Receipts* | *Profits* | *Ratio* |
|---|---|---|---|
| 1965 | $39, 041, 000 | $647, 000 | 1. 66 |
| 1966 | 62, 774, 000 | 1, 122, 000 | 1. 79 |
| 1967 | 112, 931, 000 | 2, 681, 000 | 2. 37 |

On the basis of the above statistics, therefore, the year 1965 may be viewed as an historical base year of normal or peacetime earnings. We reject plaintiff's arguments that there is no "normal" year in plaintiff's business because of the "cyclical" nature of the industry. If by "cyclical" plaintiff refers to the fact that volume of production rises sharply in wartime, then this is a fact which is shared by most companies which enter into renegotiable contracts, and was a fundamental reason for enactment of the Renegotiation Act. Plaintiff originally entered into the GOCO business because competition in other areas was so severe. It could not have expected that in the majority of years of operations the United States would be involved in a war requiring maximum production and affording opportunity for increased profit levels. It could not have reasonably expected during the period 1962–65 that a war was approaching which would result in much higher profit levels. We have no reason to believe that plaintiff viewed its profit in the year 1965 to be unreasonably low.

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[19] The rise in fees and profits which is the subject of this section was limited to the Army plants. The fixed fee for managing the two AEC plants was the same in 1967 as in 1966. It is held on the record to have been reasonable—neither too high nor too low. The Government's contention of excessiveness by reason of profits under the Army contracts above does no violence to the provision of the Act for appraisal of profits of a contractor on an overall, fiscal year basis. 50 U.S.C. APP. § 1215(a) (1970). Cost-plus contracts such as these Army contracts have very great potential for excessive profits. The regulations provide for their special scrutiny. Regulations, § 1460.2 (b); *see Pressed Steel Car Co. v. War Contracts Price Adjustment Bd.*, 20 P-H TAX CT. MEM. 312, 5 CCF ¶ 61,149 (1951).

Nor were plaintiff's operations in 1967 fundamentally different from those in 1965. Operation of the AEC plants continued throughout. Plaintiff produced ammunition for the Army in 1965 just as it did in 1967, though the normal or peacetime level of production required the use of only one plant at a relatively low level of production, rather than two plants producing near capacity.

Finally, we note that whatever expectations or hopes plaintiff might legitimately have for increased profits in wartime are not ignored in the renegotiation process. For example, plaintiff's increased profits and profit margin in 1966, resulting from increase in volume due to war, were not found to be excessive by the Renegotiation Board.

Having established the year 1965 as a representative base year of normal production and earnings for plaintiff, we are able to draw some conclusions about the reasonableness of plaintiff's profits in 1967.

As volume increased sharply in 1966 and 1967, total fixed fees mounted correspondingly. The amount of the fee per unit of ammunition by and large remained the same, though greatly increased quantities were produced. Orders were placed to the limit of capacity of GOCO plants to fill, without competition either as to estimates of costs or fixed fees, and substantially without negotiation as to fees.

Fresh discussions or negotiations as to the amount of a fixed fee per unit took place about once a month, and were limited to fees for experimental, new, or pilot lots or items in which a technological development had brought about a drastic reduction in estimated costs. Once a fee for a unit of ammunition was established, it would remain the same in all repeat orders. For instance, the fee paid per unit, at the Iowa plant, for 175-mm. projectiles remained at $0.27 per unit from 1966 to 1970,[20] though costs went up and down, and though fees had been fixed on the basis of a shorter war and shorter production runs than eventuated. Hundreds of repeat

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[20]

| | | | | *Percentage of Fee to Unit Cost* | |
|---|---|---|---|---|---|
| *Period* | *Quantity* | *Unit Cost* | *Fixed Fee* | *In Evidence* | *(Correct)* |
| 1966 | 505,000 | $8.338 | $0.27 | 3.35 | (3.24) |
| 1967 | 111,000 | 7.724 | 0.27 | 3.62 | (3.50) |
| 1968 | 485,000 | 6.904 | 0.27 | 4.07 | (3.91) |
| 1969 | 833,000 | 5,683 | 0.27 | 4.99 | (4.75) |
| 1970 | 173,000 | 7.694 | 0.27 | 3.64 | (3.51) |

orders were placed, and fees were agreed to, cursorily, on the telephone. Moreover, the same fixed fee was with rare exceptions paid to all the contractors who produced an item.

No consideration was given to reduction in the fixed fees for quantity. Indeed, one of the reasons for the fixed-fee-per-unit system was that it would obviate the need for negotiations over fees on repeat orders. The paramount objective was production, not economy or limitation on profits, and the procurement authorities wished to avoid the delay caused by protracted negotiations over fees. The APSA reports on the two Army plants put it simply: "There have been no significant refunds or price reductions."

The increase in production made no financial demands on plaintiff. The necessary increases in costs of training, recruitment, materials, equipment and facilities were all paid for by the Government. Free of the need to provide capital to finance the increased capacity and production, plaintiff was able to spread its nonreimbursable overhead costs—largely the relatively stable cost of corporate headquarters—over the greatly expanded number of units produced. The nonreimbursable cost of overhead rose by only $67,000 in 1967 over 1966, from $755,000 to $822,000, though receipts rose from $62.7 to $113 million. Profits in 1967 were 314 percent higher than in 1965 while receipts rose only 189 percent during that 2-year period. By comparison to 1966, profits in 1967 were 139 percent higher while total receipts went up a much lower 80 percent. Plaintiff's margin of profit rose from 1.66 in 1965 to 1.79 in 1966 and 2.37 in 1967.

This combination of increased volume due to war demand, decreased competition, and rising profits and profit rates resulting from the spreading of overhead over more units of production, has traditionally signaled the existence of excessive profits. It is a cardinal principle of statutory renegotiation that where expanded war production decreases unit costs and increases the contractor's profits "without exceptional effort and without corresponding increases in costs, * * * the Government should normally get the principal benefit in more favorable prices, or in renegotiation." Regulations, § 1460.10(b)(3). The principle first appeared in administrative statements issued in 1942 and 1943 under the first renegotiation laws, and was approved by the Supreme Court in *Lichter* v. *United States*, *supra.*

The first of these directives stated that in considering what is "a reasonable war-time margin of profit," consideration should be given to various factors, among them "the volume of sales, the allowable percentage being reduced on a graduated scale as the volume increases." [21]

The second directive emphasized the special applicability of the principle where capital and plant come from the Government: [22]

> 1. *General principles followed in determining excessive profits.*—In considering whether costs or profits on war contracts are excessive, the price adjustment boards are guided by the following broad principles:
>
> * * * * *
>
> (d) That as volume increases the margin of profits should decrease. This is particularly true in those cases where the amount of business done is abnormally large in relation to the amount of the contractor's own capital and company-owned plant, and where such production is made possible only by capital and plant furnished by the Government.

A leader in the development and administration of statutory renegotiation, Mr. Laird Bell, chairman of the Navy Department Price Adjustment Board and vice chairman of the War Contracts Price Adjustment Board, stated, in 1944, that where no capital is required to finance an expanded wartime production which creates sharply increased profits, the contractor is "properly rewarded" with "a very modest increase over the * * * profit of the [prior] year. In short, his profit ratio should decrease in some more or less definite relationship to the increased volume."[23]

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[21] *Principles, Policy and Procedure To Be Followed in Renegotiation,* War Dept. Price Adjustment Board, August 10, 1942, reprinted in *Hearings Before the Subcomm. of the Senate Comm. on Finance on Sec. 403 of Pub. L. No. 528,* 77th Cong., 2d Sess. (Sept. 29 and 30, 1942), *supra,* note 3, at 39.

[22] *Joint Statement by the War, Navy and Treasury Departments and the Maritime Commission—Purposes, Principles, Policies and Interpretations Under Sec. 403 of the Sixth Supp. National Defense Appropriation Act of 1942, as Amended by Sec. 801 of the Revenue Act of 1942 (Public 753, 77th Cong.). Oct. 21, 1942,* March 31, 1943, reprinted in *2 Hearings Before the House Comm. on Naval Affairs on H.R. Res. 30,* 78th Cong., 1st Sess. (1943), *supra,* note 3, at 1028.

The same views were expressed under the Renegotiation Act of 1951 by Mr. John T. Koehler, the Chairman of the Renegotiation Board during the first 3 years after its creation under the 1951 Act, in an address to the American Management Association in 1952. He expressed the view that the benefits of decreased costs from expanded wartime production are so much the Government's that the contractor should get a lower profit per unit of expanded wartime production than on prewar, peacetime production. *See* J. T. Koehler, *An Imaginary Renegotiation Case—How Statutory Factors Are Applied*, speech delivered to the American Management Association, 1952, reprinted in *The Renegotiation Guide* 59, 60 (1957).

By these statements of the principle, taken in isolation from the other statutory factors, plaintiff should be allowed profits on increased quantities at a rate *less* than its 1965 rate, not more.[24] As plaintiff rightly urges, the principle cannot be applied rigidly, for if it were, a GOCO contractor would have no incentive to lower the Government's costs. It is, however, an important principle to be applied in conjunction with the other relevant criteria.

The second comparison required by the regulation to be made, where feasible, is the contractor's costs and profits in the year in question vis-á-vis those of other contractors. A GAO report to the Congress, entitled "Defense Industry Profit Study" (1971), shows that profit as a percent of sales for Department of Defense GOCO contractors in 1967 averaged 3.1 percent. A second study, released by the Department of Defense, shows that in 1967 the average profits of Department of Defense GOCO ammunition plants, as a percentage of costs, was 3.1 percent; of 34 contracts included in the study, the profit ranged from a high of 6.7 percent to a low of 1.7 percent.

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[23] L. Bell, *Major Factors in Determining Excessive Profits*, Transcript, Univ. of Chicago Conference on War Contracts, Renegotiation and Termination, April 10–12, 1944, reprinted in *Coordinators' War Contracts Guide* 13 (1944).

[24] Had plaintiff's rate of profit for 1967 been *equal* to the rate, 1.66 percent, of 1965, plaintiff's 1967 profits would have been $1,875,000 or $806,000 less than plaintiff actually received. Rigid application of the principle would thus result in reduction of plaintiff's profits by more than $806,000.

The 3.1 percent average in the above studies is a *pre*-renegotiation figure. Thus the average itself has not been examined for excessiveness, and we should exercise care in comparing plaintiff's profits with an average profit which may itself be excessive. For instance, we know that another GOCO contractor which operated a large ammunition plant for the Army in 1967 received a pre-renegotiation profit amounting to 3.1 percent of sales. The Renegotiation Board, however, determined that those profits in excess of 2.7 percent of sales were excessive and reduced the contractor's profit margin accordingly. The fact that the 3.1 percent average is thus inflated does not, however, destroy the usefulness of the comparison altogether. Industry averages will seldom be entirely satisfactory for purposes of comparison, and we should not expect otherwise. We think it may fairly be inferred that the industry average, after reduction for excessiveness, would have been in the range of 2.5 to 3.0 percent of sales, and in any case higher than plaintiff's 2.37 percent profit margin.

It is true, as defendant stresses, that the average is made up of plants of various sizes and that individual profit margins, prior to renegotiation, ranged from 6.7 percent to 1.7 percent. Further information, if available, pertaining to the costs, profits, efficiency, etc., of the individual contractors which comprise the average might have presented a clearer picture of plaintiff's relative standing. Plaintiff, however, did not possess, and was unable reasonably to obtain, such information. By placing into the record the industry averages which were available, plaintiff has met its burden of going forward. *Lykes Bros. S. S. Co.* v. *United States*, *supra*, 198 Ct. Cl. at 326–27, 459 F. 2d at 1401. Usefulness of the average as a guidepost is not diminished by the obvious fact that diverse contractors make up the average.

In sum, the two comparisons required by the regulation for determining reasonableness of costs and profits lead to widely divergent conclusions. On the one hand, comparing plaintiff's 1967 profits with normal or peacetime earnings, it appears that plaintiff's profits were excessive to a very great extent, that plaintiff's profit margin should be reduced from 2.37 percent to less than 1.66 percent. The comparison with other GOCO contractors, on the other hand, suggests that plaintiff's margin of profit is not excessive in any degree.

There is one additional datum in the record bearing on the reasonableness of plaintiff's costs and profits in 1967. An expert witness—an economist—testified for defendant that plaintiff's profits were excessive to the extent of $551,000. This figure reflects the expert's view that the percentage rise in profits from 1966 to 1967 should not have exceeded the percentage rise in sales for those years. The expert's failure to justify in detail the method he chose for calculating excessive profits lessens to some degree the weight we might otherwise give to his testimony. We nevertheless accept it as one element in defendant's meeting of its burden of proof of excessiveness.

## IX

### *The Public Interest and Fair Dealing*

Section 103(e)(6) (note 1, *supra*) provides for consideration of such "other factors the consideration of which the public interest and fair and equitable dealing may require."[25]

The renegotiation process requires that a balance be struck between the public's interest in prices for war materiel at fair and uninflated prices and the contractor's right to fair and equitable treatment. On the one hand the profit allowed must not be so high as to condone profiteering, nor yet so low as to deter the production of war materiel efficiently and in volume, indispensable for success in defense or war.[26] These propositions are implicit in the execution of the next and last step in the process of redetermination of the excessiveness of plaintiff's profits.

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[25] The statute contemplates that such factors would be adopted by the Board and published in the regulations. That the Board has not adopted any such additional factors (Regulations, § 1460.15) is not a bar to consideration by the court on a redetermination of excessive profits under sec. 108 of the Act. 50 U.S.C. APP. § 1218 (1970).

[26] Regulations, § 1460.10(b)(3); *Report of the Special Senate (Truman) Committee Investigating the War Effort*, S. REP. 10, Part 5, 78th Cong. 1st Sess. 1–3 (1943), quoted in *Lichter* v. *United States*, *supra*, 334 U.S. at 760, n. 6; *Efficiency and Effectiveness of Renegotiation Board Operations*, Report of the House Committee on Government Operations, H.R. REP. 92–758, 92d Cong., 1st Sess. 14 (1971); H. S. Hensel & R. G. McClung, *Profit Limitation Controls Prior to the Present War*, *supra*, n. 7., at 216.

## X

### *Conclusion*

The final step is, of course, the determination of the amount of plaintiff's excessive profits in 1967, in light of all the statutory factors discussed above. We must first dispose, though, of one final argument by plaintiff. Plaintiff argues that it should not be subject to renegotiation at all, that the facts of this case do not fit those for which renegotiation was intended. In so arguing, plaintiff relies on testimony by the contracting officer to the effect that he intended plaintiff's fees to be approximately 3 percent, as they were, and that he considered that level of fees to be reasonable.

The contracting officer's view of what was reasonable is not controlling on the court although certainly it is one element to be evaluated. The record shows that when war demand resulted in sharply increased quantities of production, no thought was given to decreasing unit fees. While, as the contracting officer testified, unit *fees* were maintained in 1966 and 1967 at approximately the same 3-percent level as in the prior peacetime years, the level of *profit* rose from 1.66 percent in 1965 to 2.37 percent of sales in 1967. We believe that, to the extent that plaintiff's profits are determined herein to be excessive, the contracting officer's opinion of reasonableness is simply incorrect if it stands alone.

We believe defendant has met its burden of proof to show excessiveness. It has done so by demonstrating that plaintiff's risks were virtually nonexistent, that plaintiff invested little capital, and that its rise in profits was due to increased wartime volume, without competition and with no downward adjustment in fees for increased quantity. It has buttressed its evidence with expert testimony. Defendant has persuaded us, on the record, that plaintiff's 1967 renegotiable profits were unreasonably high. Our examination of all relevant factors, including the contracting officer's views, leads us to the conclusion that plaintiff's renegotiable profits in 1967 were excessive in the amount of $423,000. As a percentage of sales, plaintiff's profits are thus found to be nonexcessive to the extent of about 2 percent. This figure lies between the disparate results suggested by the comparisons to normal earnings on the one hand, and to profits of other similar contractors, on the other. After reduction by $423,000, plaintiff's allowable 1967 profits are $2,258,000, more than twice the profits of 1966 although volume did not double from 1966 to 1967, and far more than the "very modest increase over the * * * profit of the [prior] year," suggested by Mr. Laird Bell. At the same time, of course, reduction of plaintiff's profit margin to 2 percent of sales results in plaintiff's earning a margin of profit less than the Department of Defense GOCO industry 3.1-percent average for that year. A 2-percent return takes into account, favorably, plaintiff's efficiency, character of business, and significant contribution to the defense effort. At the same time it recognizes that plaintiff incurred virtually no risk and invested little capital of its own. This result, predicated on all the statutory factors and the industry experience, is in the public interest but at the same time deals fairly with plaintiff which deserves to be compensated equitably for work well done in increased volume for the war effort.

Judgment for the United States in the amount of $423,000, less appropriate tax credits, must be entered on defendant's counterclaim, with interest as provided by law.

NICHOLS, *Judge*, with whom KASHIWA, *Judge*, joins, dissenting:

I am grateful for the court's candid admission that the plaintiff made a *prima facie* case. This means that our holding in *Lykes Bros. S. S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972) comes into play. The Government bears the burden of proof. It "shifts to the Government to prove that the plaintiff's profits were excessive and the extent thereof. This encompasses not only the burden of going forward with evidence after plaintiff's case in chief is closed, but also the burden of persuasion." [Fn. omitted] 198 Ct. Cl. at 327, 459 F. 2d at 1402.

We thus intended to effect a sweeping change in the previous Tax Court procedure in redetermining excessive profits under the Renegotiation Act of 1951, 50 U.S.C. App., §§ 1211-1224. That tribunal started with a presumption the Board was correct. The contractor had to show wherein it was wrong and all the Government had to do was to bolster the determination up when it appeared to be crumbling under the attack. Despite the *de novo* nature of the proceeding which the Congress had attempted to enact, the structure of fact and reason that emerged after trial was mostly the Board's. Much, other than evidence, came into the Board determination by perfectly legitimate routes, for an open, adversary, due process proceeding was not required there. It stayed with the Tax Court determination, and the result depended for its foundation in part on the knowledge and experience of Board members, and on what they learned apart from any due process record. We were going to change all that. If the Government wanted us to uphold the Board it must prove to us the Board was right with no help from any presumption.

To the extent the Government does not supply reasons and techniques, it calls on us to fabricate our own. Yet, in *Bethlehem Steel Corp.* v. *United States*, 206 Ct. Cl. 122, 128, 511 F. 2d 529, 532 (1975), we pointed out in a different but related context, that persons " 'learned in the law' can hardly be also expected to be so expert as not to need guidance as to the techniques of reasonable profit determination." We there decried "do it yourself guidelines" and "seat of the pants navigation."

It would seem to follow that in the absence of a satisfactory structure of facts and reasons, erected on the record in accordance with the factors prescribed in the statute, 50 U.S.C. § 1213(e), that supports a refund determination, it is our duty to issue the contractor a clearance, or no excessive profits determination, and this even though we may find the task distasteful because we personally feel the contractor made too much money. This is the transformation we have effected. It is our duty to swallow the medicine we ourselves brewed in the *Lykes* case like little men, whether we relish it or not.

I find it impossible to conceive how any tribunal, composed as this court is, can determine excessive profits in a case such as we have made these cases to be, without the help of expert testimony. The following colloquy at the oral argument is, I think, revealing:

> Judge NICHOLS: "How can we get along without them [experts] here?"
> Mr. RANNEY: "Well, your Honor, this was one of the early cases tried. We did have one expert in the conference. I do feel that the records that will be coming forth in the other cases—with the one case that is cited—in all cases there were experts on both sides—I know in that case particularly on the Government side. There were other cases in the process of being tried at this time—are going to ——"
> Judge NICHOLS: "The best expert is * * * (inaudible)"
> Mr. RANNEY: "We are in the same boat as the court. When the law was changed in 1970 and the cases initially assigned to the Court of Claims section of the Civil Division, we hadn't ever tried one of these before. In the Tax Court they were handled by a separate group. As a result, we had to learn how to walk before we could run. So we were sort of feeling our way along on these earlier cases."
> Judge KUNZIG: "[Is this a] creeping or running or walking case?"
> (Laughter.)

No one would suggest that the members of this court appraise a tract of land by just looking at it. Somehow, a renegotiation is different.

It seems apparent to me that the Government could qualify as experts many of those who participated in making the Board decision, either in a member or staff capacity. To do this would in no way compromise the *de novo* character of the trial in this court. As for the contractor, its own officers could give competent testimony, or others could be retained. If we receive some self-serving testimony, we should know how to discount that feature of it. There are many persons formerly engaged in renegotiation on the Government side, now resigned or retired, who no doubt could give informed and knowledgeable testimony on behalf of a contractor who retained them. There are related occupations such as securities analysis. In fact, the ablest renegotiator I ever knew, Chairman Ed. Barker, Navy Price Adjustment (Renegotiation) Board, circa 1946–48, came into renegotiation direct from the securities business. By ablest, I mean the best able to articulate an analysis of the reasonableness or excessiveness of a contractor's profit in light of direct application of the factors, one by one.

This case is an example of the lawyer's delusion that we can do everything without appropriate help. We tend to under value the other word-smithing and idea-mongering disciplines, such as economist, or accountant, and to assume that whatever they can do we can do better. However, I do not rate economists high among the disciplines that can be most helpful in renegotiation. We had a well-qualified economist on the Renegotiation Board staff in 1951–54, but he was, rightly I think, never asked to recommend an individual excessive profits determination. He advised us on profits, costs and trends in whole industries. I valued his services much more than the Board did.

The court says it had expert testimony here. This consisted, on the Government side, of one economist. The court's endorsement of him in the opinion is lukewarm indeed. The value assigned his testimony by the Government is shown by the above-quoted colloquy at oral argument. The value assigned by our trier of fact is shown by his findings which, before amendment by the court, nowhere mentioned this testimony. The court added findings 47 (a) and (b). The trial judge allowed to plaintiff less as a reasonable profit than this Government witness would have allowed.

The contracting officer testified and might be considered a kind of expert, though his operating capacity in the case would conflict with the status of a true expert. He thought reasonable the 3% profit on receipts he expected and intended all GOCO contractors to make.

The seat-of-the-pants character of the decision now proposed is best illustrated by the fact that both the trial judge and the court regard "normal earnings", *i.e.*, earnings in a normal year, as the best yardstick to justify a refund determination. However, they differ as to what "normal" year to use. The trial judge picked 1966 and the court 1965. Yet the lower "normal" profits in 1965 are referred to by the court to justify a relatively higher retained profit for 1967, the year under review, and the higher "normal" profits of 1966 were invoked by the trial judge to support his recommended lower retained profit for 1967. If the trial judge and the court really *used* these so-called "normal" figures, the court should have come up with a bigger refund than the trial judge did.

Obviously, 1966 was not a normal year, with respect to the Army business where the alleged excessive profits were. The contractor was moving out of standby status, activating one entire dormant plant and new lines in another, and in so doing incurred costs that had not been incurred before and would not be incurred in full production, "starting up" and "learning curve" costs, and what the Board called "support activities". As the fee per unit of production was fixed, while the cost per unit was high, the profit stated as a percentage of cost was low. As to 1965, that was the final year of little or no consumption of the product, virtually a stand-by year. In a type of business where full production is attained only in time of emergency, is a stand-by year to be deemed a normal year? Maybe so, but before accepting the notion, I would like to see some informed and reasoned support for it. In face of both opinions, I would hold that for a contract manager of GOCO ammunition plants, the statutory factor of "normal earnings" is wholly unhelpful and should be discarded as a measure to determine the reasonableness of profit earned. The "normal earnings" factor is of value in dealing with companies that convert to defense production, as the auto companies did in World War II, or with companies producing articles, such as trucks, having both war and peacetime uses. The effect of its use here is simply to penalize a company that stayed in existence through lean years in stand-by as against a hypothetical one that might have been newly formed to manage GOCO plants.

As the contractor reached full production at the start of 1967 its efficiency improved and as a result the unit costs declined. The Government got benefit from this efficiency in having to reimburse only for lower unit costs. The court thinks that lower unit fees should also have been negotiated. The statute says that favorable recognition *must* be given for efficiency. The court is changing the trial judge's proposed opinion by underlining the word "must" as quoted by him. I would like to see a demonstration, then, that the court is not penalizing efficiency instead of rewarding it. Should the cut in production cost be large enough, it might be arguable the unit fee should be increased, not decreased. This is the essence of the familiar "incentive" contracting, which is not in contention here, of course. The proper concept still is that the Government and the contractor should share the benefits from increased volume and efficiency. The court here fails to demonstrate that if the contractor had remained inefficient, *i.e.*, had failed to reduce the 1966 unit costs, the court would not have allowed a larger profit simply because, stated as a percentage of cost it looked smaller. The court has also failed to demonstrate that the share each side enjoyed in the benefits from volume and efficiency was not a fair share before renegotiation.

To take the 177 mm. projectile produced at the Cornhusker plant as typical, the figures in the court's fn. 20 show a unit cost reduction of $.61.4 (61.4 cents) from 1966 to 1967. In this instance, there was a reduction, not an increase, in volume, so the saving must be due wholly to efficiency. The fixed unit fee was $.27 (27 cents) both years. I take it, applying the proposed refund proportionately to this unit fee, the court is reducing it to about $.22 (22 cents). Thus the saving to the Government is increased from $.61.4 (61.4 cents) to $.66.4 (66.4 cents) and the reward to the contractor is cut by five cents. If the court is doing anything but penalizing the contractor for its efficiency, I would like to have its explanation how. If there is any sharing of the reward for efficiency between Government and contractor, how and where? There were further savings per unit of $.82.0 (82 cents) in 1968 and $1.22 (one dollar and twenty-two cents) in 1969, by the end of which year, extrapolating the court's decision according to logic, it would seem the fee should be eliminated entirely.

The quotes the court uses from Laird Bell and John T. Koehler, are misleading in that both were speaking about fixed price sales, where the contractor would monopolize all the cost savings due to increased volume unless the price were reduced by negotiation or renegotiation. Here, with fixed unit fees plus cost reimbursement, the Government automatically gets a large benefit from efficiency and volume saving, and the sole question is, how much more would be fair to exact.

The court makes a to-do about the absence of risk and low commitment of contractor capital. Yet it surely knows that contractors who incur risks and use their own capital are not obtainable at under 3%. Here the unit fees are, virtually, commissions.

I am not disputing that possibly some fee reduction should have been made. Or possibly not. My complaint is that in our very first renegotiation case to come to us on the merits, we are not adhering to the standards we set for ourselves in the *Lykes* case. We are not requiring the Government to prove its case. As I see it, we are not even analyzing the issues to the point where we can tell for sure whether we are rewarding or penalizing efficiency. Insistence on standards of proof would benefit the public more than the small amount—as such cases go—to be recovered here as a refund. I would issue a judgment clearing the contractor of liability for excessive profits for its fiscal year 1967.

## FINDINGS OF FACT

**1.** Plaintiff, a West Virginia corporation, with a home office in Lexington, Kentucky, has since 1958 been engaged almost entirely in the management, operation and maintenance of four "GOCO" plants (GOCO for Government-owned, contractor-operated), two owned by the Atomic Energy Commission and two owned by the Department of the Army.

The AEC plants, one near Amarillo, Texas, and the other in Burlington, Iowa, are nuclear ordnance plants in which the primary work is the assembly of nuclear weapons from high explosives manufactured by plaintiff and nuclear and other components supplied by other GOCO contractors. The two Army plants, "Cornhusker" in Grand Island, Nebraska, and "Iowa" in Burlington, Iowa, are conventional ammunition plants, administered by the Ammunition Procurement and Supply Agency (APSA) for the Army Munitions Command. The primary work in these plants is the loading, assembly and packing of conventional large caliber ammunition from high explosives manufactured by plaintiff and other components supplied to plaintiff. The plants and all facilities and equipment are Government-owned.

2. GOCO plants originated in the preparations for possible involvement in World War II, when the Government, finding its arsenals inadequate, sought to promote private investment in a munitions production capability. Private industry was, however, found to be unwilling to commit the substantial capital required for the construction of munitions plants. The Government thereupon decided to assume the capital costs, and embarked on a program of building munitions plants at public expense and arranging for their private operation at Government cost, on a basis of minimal risk-minimal investment for the private contractor-operator. By the end of World War II, 84 plants were under the program either built or in process of construction.

The AEC's design laboratories have no production facilities, and the AEC depends on such contractors as the plaintiff to operate the facilities owned by the AEC and to meet the designers' specifications.

During 1967, private contractors operated 26 GOCO plants for APSA, and additional GOCO plants were operated for other defense agencies. Generally speaking GOCO ammunition plants of the kind operated for APSA produce the chemicals and explosives that go into metal components (supplied from private-sector, non-GOCO sources) and also load, assemble and pack the ammunition. GOCO-made items are obtainable from private sources only to a very limited extent.

In 1967, 40 prime contractors operated AEC-owned facilities employing 106,623 persons. Of these facilities, 26 among them the two plants presently under consideration, represented AEC investments in excess of $25 million each. *Annual Report to Congress of the Atomic Energy Commission for 1967* 281, 317 (1968).

Plaintiff came to the work of operating the four GOCO plants involved in this case by virtue of experience in heavy construction, including the building of ammunition plants, and the design of such plants, including portions of the four plants presently involved. The plaintiff left the construction field because of the acute competitive conditions which diminished the profit prospects.

3. The issue herein is the amount of the excessive profits, if any, of the plaintiff in 1967, to be determined de novo under the Renegotiation Act of 1951, as amended, 65 Stat. 7, ch. 15, as amended, 50 U.S.C. APP. § 1211 *et seq.* (1970), as amended (Supp. II, 1972).

Over 99 percent of plaintiff's renegotiable business is represented by its four GOCO contracts. It is agreed that the nature of the remainder of the plaintiff's renegotiable business need not be considered.

Plaintiff's fiscal year is the calendar year. The year under review is thus calendar 1967.

4. The contracts for the operation of the two AEC plants are cost-plus-fixed-fee contracts. They were treated as one, and a fixed fee of $864,000 was paid to plaintiff as its compensation under the contracts. The fee was negotiated annually on the basis of estimated costs, but was the same in 1966 and 1967. In addition, in 1967, plaintiff was paid $16,640 for construction work at one of the plants, making its total fees in 1967 $88,640.

Reimbursed costs in 1967 at the AEC plants were $27,526,427. Total receipts, consisting of reimbursed costs plus fees, were $28,407,067.

5. The contract for the operation of the Iowa Army plant is a cost-plus-fixed-fee per unit of ammunition produced. Unit production fees—so much for an item produced—vary with the items; for instance, the fee for the production of a 175-mm. shell was $0.27. Under this contract plaintiff was in 1967 paid $49,465,841, consisting of $47,978,275 in reimbursed costs and $1,487,567 in unit production fees. Total receipts under the contract were thus $49,465,841.

6. The contract for the operation of the Cornhusker Army plant is also a cost-plus-fixed-unit-fee contract, but it provides in addition for an award fee in the discretion of APSA, based upon superior performance. Under this contract plaintiff was in 1967 paid $34,148,094, consisting of $33,167,488 in reimbursed costs and $980,606 in unit production fees. Plaintiff received $53,449 in award fees, which was 30.3 percent of the maximum of such fee; the record is unclear as to whether this award fee is included in the above $980,606 sum.

**7.** (a) The plaintiff's total receipts in the calendar year 1967 were $113,428,408.01, of which over 99 percent or $112,931,469.39 represents renegotiable receipts. Its total net profits (including income from investments), before federal and state income taxes, amounted to $3,116,560.32, of which $2,681,800.53 was profit derived from renegotiable business. Since almost all of plaintiff's business is the operation of GOCO plants under cost-plus-fixed-fee contracts, renegotiable profits consist of fees less nonreimbursed costs, which latter are almost exclusively the costs of plaintiff's home office; and renegotiable receipts consist of reimbursed costs plus fees.

(b) Renegotiable receipts and profits in 1967, here under review, are thus receipts of $112,931,469.39 and profits of $2,681,800.53. The profits are 2.37 percent of the receipts.

**8.** (a) An unclassified description of the plaintiff's work in 1967 under the two AEC contracts, approved by the AEC and stipulated by the parties, is set out in the following subparagraph (b).

(b) Mason & Hanger-Silas Mason Co., Inc. (M&H) (the plaintiff) operates Atomic Energy Commission (AEC) facilities under two contracts with AEC: Contract W-49-010-AMC-68(A) for the operation of the AEC facilities located at Burlington, Iowa, and Contract DA-11-173-AMC-487(a) for the operation of the AEC Pantex facilities located at Amarillo, Texas. These two plants are the only two AEC plants for the final assembly of nuclear weapons, and all nuclear weapons of stockpile quality are processed in these plants. The following statements are as applicable to 1967 as to other years.

About 10 percent of M&H's work for the AEC is research and development work relating to the field of nuclear weapons. This work includes the formulation, pilot manufacture, and testing of new explosives and the establishment of compatibility of these explosives with other weapons materials. Development is also directed toward explosive gadgetry for weapons use. About 20 percent of M&H's work consists of maintenance and test of nuclear weapons in the AEC's stockpile. The remainder of M&H's work for the AEC involves the formulation, fabrication and testing of explosives and explosive components for assembly into nuclear weapons and the final assembly of the nuclear weapons.

M&H's work includes the receiving and qualitative testing of raw explosive materials through establishing chemical content, purity, and parameters of detonation characteristics. The explosives in some cases must be recrystalized and formulated with other chemicals to establish weapon quality materials. These also must be tested to establish detonation characteristics.

The accepted explosives must then be fabricated through extrusion, casting or pressing into configurations desired for further processing. The rough configurations are then machined to tolerances of 0.001 inches using computer controlled milling and turning equipment into shapes required to further assemble. The explosives, after being bonded with metal shells or with each other, are ready for weapon assembly.

Testing of these explosive configurations is accomplished using equipment which is "state of the art" in measurement of fast events. Timing of these events is in terms of one-hundred millionth of a second with oscilloscopes and photographic equipment. The performance of the explosive configurations is exacting and must be as near perfection as possible.

The assembly of a nuclear weapon requires precision found in few, if any, industrial or laboratory operations. Parts, including nuclear components, fusing and firing units, and case parts are received from other integrated GOCO contractors. These are individually tested, serial number controlled and precision assembled by M&H.

Explosive actuators and other components in modern nuclear weapons are developed and manufactured by M&H. All modern nuclear weapons in the stockpile were assembled by Mason & Hanger-Silas Mason Co. The high explosives used for these weapons were fabricated by M&H in these two plants.

Nuclear weapons units in the field are returned for teardown and testing to assure that degradation of the stockpile has not occurred. This requires testing with precision analysis equipment and interpretation by competent technical personnel.

Weapons which have been damaged through accident or use are returned to M&H for repair or for disposal. M&H has participated in the clean-up on the site of damaged weapons, such as that in Thule, Greenland. The contaminated materials were returned to M&H for safe processing and disposition.

Trained teams are maintained by M&H to respond to any nuclear or radiation accident throughout the world.

(c) None of the plaintiff's work for the AEC was subcontracted.

9. (a) On October 15, 1968, the renegotiation affairs officer of the AEC, in response to a request from the Renegotiation Board for a performance report on the plaintiff's AEC contracts for 1967, wrote to the Renegotiation Board stating, among other things, that the contractor's performance was considered satisfactory and the overall objective, including economical performance, had been achieved; and that although there had been a continued improvement in services and performance of work, the contractor did not make an outstanding contribution to the defense effort in 1967. The letter is set out in the following subparagraph (b). On April 8, 1970, the general manager of the AEC wrote to a Board member of the Renegotiation Board a lengthy letter praising plaintiff's 1967 performance in the area of production engineering and related activities. The letter is set out in the following subparagraph (c).

(b) The October 15, 1968 letter reads as follows:

> The following information on Mason & Hanger-Silas Mason Co., Inc., contracts as listed in the subject above, is provided as requested in your letter dated September 26, 1968. It should be noted that scope of work for both contracts under your review is basically the same, i.e., "the fabrication of high explosive components of atomic weapons and other elements and the assembly of components with other materials". The contractor also performs many supplementary tasks of importance such as development support, stockpile sampling, new materials systems testing, and other quality evaluation programs; salvage, reclamation, and/or destruction of

weapons materials and parts. Since both contracts are basically the same our comments to your questions are applicable to each contract. They are furnished below in same sequence as the questions asked in your aforementioned letter.

1. No significant differences.

a. Same difference in the scope of operations in that disposal activities were included in 1967 which were not included in 1961.

b. Basically the fees were not measured differently. The budget assumptions and directive schedule workload documents represent the basis for the base fee estimates.

c. Advance Account Reimbursement or Letter of Credit. The contractor does not receive reimbursement since his operation at both locations is covered by prefinancing except for his fixed fee.

2. The contractor's performance record in 1967 was considered satisfactory and the overall objective (including that of economics performance) had been achieved.

3. There was no appreciable degree of financial risk placed upon the contractor during 1967 performance.

4. Although there has been a continued improvement in services and performance of work, the contractor did not make an outstanding contribution to the defense effort in 1967.

5. Yes, there are audit reports available for possible ERRB review if deemed necessary. If required, please advise the particular audit function or area concerned so that the proper audit report can be forwarded.

6. There were no known claims pending, either between the Government and contractor, or between contractor and subcontractors, at the end of Contract Year 1967.

Should you require additional information please advise.

(c) The April 8, 1970 letter reads as follows:

Pursuant to an inquiry by Mr. Ross Pancoast, Deputy Director, Office of Review, and in the hope that it will assist you in the execution of your responsibilities in determining the competency of Mason & Hanger-Silas Mason Co., Inc., in performing the terms of its contract during CY 1967 with the Atomic Energy Commission, we are submitting the following information setting forth areas in which credit should be given to this contractor for production engineering and related activities.

> Mason & Hanger-Silas Mason Co., Inc., organizations at both the Pantex and Burlington AEC plants possess scientific and engineering knowledge and know-how in the various technologies associated with fabrication of high explosive parts and assembly of nuclear weapons which we believe would be extremely difficult or impossible to obtain from private industry in the development and production time scales with which we work. Some of this expertise pushes the state-of-the-art and to the best of our knowledge is not available anywhere else in the United States except in our design laboratories. It should be noted that our design laboratories, in general, do not have a manufacturing capability and must depend upon our production agencies to develop equipment and production techniques to assure meeting laboratory design specifications.
>
> It is our opinion that the Mason & Hanger-Silas Mason Co., Inc., has performed an outstanding management service and has significantly reduced costs to the AEC by its activity in the areas of development and production engineering. Through its ideas, suggested changes, and development of processing techniques the organization has been exceptionally important in the manufacturing of a better quality product. We have enclosed a list of examples of the type of development and production engineering conducted by Mason & Hanger-Silas Mason Co., Inc., during CY 1967, the period under review.
>
> During this period, Mason & Hanger-Burlington effected cost reductions in the amount of $570,400 of which $55,600 was applicable to the first half and $514,800 was applicable to the second half of the year. During the same year, the Pantex plant effected cost reductions in the amount of $1,158,000 of which $831,000 was applicable to the first half and $327,000 was applicable to the second half of the year. These cost savings have been verified by the AEC as actual cost savings for the period.
>
> We trust the comments and information presented above will assist you in your determination. If we can be of any further assistance, please advise us.

Enclosed with the letter were examples of contract performance by Mason & Hanger-Silas Mason Co., Inc., during CY 1967, as follows:

### EXAMPLES OF CONTRACT PERFORMANCE BY MASON & HANGER-SILAS MASON CO., INC. DURING CY 1967

*Wave Generator.*

Mason & Hanger designed a line wave generator based upon parameters furnished to them by Lawrence Radiation Laboratory (LRL). No previous development of a device to produce a straight line shock wave meeting the desired configuration had ever been designed. The device was fabricated and furnished to LRL for research activities of the laboratory.

*High Explosive Pellet Location.*

Mason & Hanger performed an engineering evaluation of test firing which indicated mislocated HE pellet locations in a weapon part. As a result of this study and recommendation, the pellet positions were relocated to improve the quality of the end product.

*Loading Techniques.*

Mason & Hanger made major improvements in the techniques of extruding HE which permitted a process loading change. This change also resulted in improved quality of the finished product.

*Improved Product Yield.*

Mason & Hanger developed, through quality control engineering, a radiographic technique for minimizing rejection of parts containing extruded HE. Also, production engineering developed a process to reclaim and reload rejected parts with extruded HE. Although these actions resulted in important dollar savings, the reclamation of the parts when they were in short supply was more important to our production mission than the dollar savings.

*Hydrodynamic Testing.*

1. In connection with the design and building of instrumentation and equipment for hydrotesting, Mason & Hanger designed the firing bunker.

2. The raster scope was produced to an LRL design; however, the image recorder was designed by Mason & Hanger.

3. All interconnecting circuitry between the scope and the main control console and the test shot console were designed and installed by Mason & Hanger. All of the synchronous circuitry for the sixty raster scopes, which automatically sequence the tests, were designed and fabricated by Mason & Hanger.

4. The environmental control of the device being fired was designed and installed by Mason & Hanger. The test shot configuration, the pin dome geometry, the test plate, and other hardware were developed by Mason & Hanger in conjunction with LRL. The equipment for manufacturing pin domes and inspecting them by an electronic digital readout was developed by Mason & Hanger. The equipment used to reduce the photographic test data to numerical data was developed by Mason & Hanger. It automatically punches IBM cards for each test pin so that this can be fed into a central computer program to determine the quality levels of the components being tested. Mason & Hanger engineers also installed identical equipment for the reduction of data at LRL for the laboratory's use.

*Precision Pressing.*

The original design of LRL explosive assemblies had a small HE part which required five separate machining operations. Mason & Hanger engineers had previously developed precision pressing techniques to press to a finished shape which they applied to this HE part production. This has been incorporated into the weapon design at substantial savings to the AEC.

*Special Test Firing Facility.*

The contractor has also been involved in the development of a special test firing facility. This system makes measurements based upon the speed of light versus the speed of electricity.

*Jigs and Fixtures.*

The subassembly fixtures developed by Mason & Hanger engineering for use in locating and holding HE components and metal hardware items during actual gluing operations and cure time periods are considered outstanding. They have resulted in a minimum of rejects due to out-of-tolerance conditions.

The following are items which, although performed at both plants, are primarily conducted at the Pantex plant:

1. *Test Firing and Diagnostic Techniques.*

a. Application of hydrodynamic test firing to quality control of two-dimensional systems.

b. Research in techniques for the measurement of detonation pressure.

c. Improvements in the precision of a less expensive measuring technique (the aquarian method) and research in the attenuation of explosively driven shocks in water.

d. Research into lighting techniques for very high speed HE diagnostic photography.

e. Development of a method of intensifying and prolonging the light from exploding wires.

2. *HE Safety Testing.*

Two new tests of detonation threshold of explosives have been developed at Pantex:

a. The "Skid Test" measures the reaction when an HE sample is impacted in a skidding mode on a prepared surface. It was first developed to test protective flooring, and proved so effective that it is used to compare explosives.

b. The "Friction Sensitivity Test" in which a small sample is forced against a standard surface and then dragged rapidly across it at a fixed energy level.

3. *Characterization of HE.*

R&D resulting in many contributions in the field of particle characterization such as sizing by sieves, semiautomatic microscopy, and calibration of a variety of surface area measurements.

4. *Fabrication Processes.*

a. Development of very strong structures by filament winding, both with glass fibers and with metal wires. Research into the time-dependent response (creep, etc.) of such systems.

b. Advances in the precision fabrication of explosives, particularly in the field of numerical control such as 5 axis milling, turning, and isostatically pressing to shape of large, complex precision HE parts, etc.

5. *Process Development and Facility Design for HE/Nuclear Safety in Assembly.*

Developing the concept for an HE assembly structure to limit the effects of accidents to the narrowest possible region and designing the facility. These structures consist of a buried cylindrical wall with a deep gravel overburden, supported by a novel steel cable structural system. This work was done several years ago. The structures are known as "Gravel Gerties". They were built at both HE plants.

6. *Research for Reimbursable Work in Support of Department of Defense.*

a. Contributions of conventional military weapons by research in the shock-sensitivity of military explosives, particularly by application of AEC-developed techniques to the problem.

b. Research into the output of military weapon fuses measured quantitatively and applied to the problem of weapon reliability by advanced diagnostic methods. We understand such services are indicative of scientific expertise at the frontiers of present knowledge and were not available to the DOD anywhere else.

c. Development of new techniques by which military conventional weapons explosive systems can be characterized.

d. Contributions to the development of a very large chemical HE bomb, particularly in the initiation characteristics of a gelled slurry explosive in the development of an appropriate fuze.

10. Plaintiff's performance in 1967 of the contract for the operation of the Cornhusker Army plant was the subject of a Renegotiation Performance Report by APSA, as follows (slightly condensed):

(a) *Contract Information.* Contract DA-11-173-AMC-19(A), dated 7 April, 1950, performed 1 January, 1967 through 31 December, 1967. This contract is a cost-plus-award-fee type of contract. The basis for the use of a cost reimbursable type contract was a Finding and Determination dated 13 February, 1950. The method of procurement was Sole Source Negotiation pursuant to 10 U.S.C. § 2304(a)(16).

(b) *Principal Product.* Production of 500-, 750-, 1,000- and 2,000-pound bombs, and loading, assembling and packing (L/A/P) of XM45 and XM41E1 mines.

(c) *Brief Description of Work Normally Performed.* L/A/P high explosive bombs, artillery projectiles and mines. Manufacturing technique involves mixing, melting and pouring explosives; and finished products with density, cavitation and other stringent standards required to be met to pass Government inspection. Components and operation supplies are either Government-furnished or purchased by the contractor.

(d) *Subcontracting.* No ammunition production has been subcontracted. Subcontracting has been limited to a minor portion of reactivation and production equipment fabrication and is not in excess of 5 percent of the total such work.

(e) *The Facilities Involved.* Cornhusker Army Ammunition Plant, a Government-owned facility at Grand Island, Nebraska. The facilities consist of real estate, buildings, fixtures and production equipment, with an estimated replacement value of $31,453,620. The contractor has made effective use of these facilities.

(f) *Level of Production.* In 1967, as a result of the war in Southeast Asia, Cornhusker AAP was operating at full capacity.

(g) *Total Billings* (contract payments, that is, costs and fees) *During Period*, $32,845,658.67 [but *cf.* finding 6].

(h) *Total Production Fees Paid to Contractor During Period.* Production fees of $882,369.61, which is 2.69 percent of reimbursed costs, plus award fees determined by APSA of $53,449.67. The contractor has received fees varying between 2 and 3 percent of the estimated cost of the contract during calendar year 1967. This fee ratio is commensurate with similar GOCO contracts. No important contracts have been negotiated with this contractor without fees [but *cf.* finding 6].

The award fee of $53,449.67 represents 30.3 percent of the potential maximum of such fee.

(i) *Contractor Performance.*

(1) The contractor has met the contract requirements.

(2) Delivery schedules were met although frequent changes were made by the Government with little advance notification.

(3) Rejection and spoilage rates are considered low.

(4) The contractor is considered average in controlling the use of materials, facilities, manpower, and production costs.

(5) There have been no strikes, stoppages, or other significant developments in labor management affecting contractor performance.

(j) *Information Concerning Reasonableness of Cost and Profits.*

(1) The adequacy and reliability of the contractor-provided cost information has been average to above average compared to other GOCO contractors.

(2) Since the subject contract is a cost reimbursable type contract, the contractor has assumed little if any risk.

(3) There have been no significant refunds or price reductions.

(4) The contractor is an average cost producer. Contract costs are based on product unit cost estimates submitted by the contractor and reviewed by the Government. Revised estimates are prepared whenever a fund deficiency or excess funding is indicated and the contract amount is adjusted accordingly. Upward revisions have generally been due to schedule changes and/or slippages in Government-furnished components.

(5) The contractor operates with $20,000 of company funds as plant working capital. The Government locally reimburses the contractor concurrent with release of payment checks that the contractor has issued.

(k) *Contractor's Contribution to Defense Efforts.*

(1) This plant is the major supplier of high explosive bombs to the Air Force. In addition, major caliber artillery projectiles and mines are produced. Through Value Engineering, a new and improved method of coating the interior of bomb casings was developed and put into use as well as other developments to improve melt loading techniques.

(2) Contractor's performance from a production viewpoint has been very good. The award fees determined by APSA represents 30.3 percent of the potential maximum of such fees.

**11.** Plaintiff's performance in 1967 of the contract for the operation of the Iowa Army plant was the subject of a Renegotiation Performance Report by APSA, as follows (slightly condensed):

(a) *Contract Information.* Contract No. DA-11-173-AMC-85(A), dated February 24, 1951, being performed January 1, 1967 through December 31, 1967. This contract is a cost-plus-fixed-fee type of contract. The basis for the use of a cost reimbursable type contract was a Findings and Determination dated February 12, 1951. The method of procurement was Sole Source Negotiation pursuant to 10 U.S.C. § 2304(a)(16).

(b) *Principal Product.* Production and loading of 76 mm, 90 mm, 105 mm, 106 mm, 120 mm, 155 mm, 165 mm, and 175 mm, ammunition, warheads, igniters, boosters, detonators, fuses, grenades, primers and mines.

(c) *Brief Description of Type of Work Normally Performed.* The contractor operates the Iowa AAP, a Government-owned facility for loading and assembly of ammunition and ammunition components in accordance with furnished schedules incorporating delivery and performance rates and provides all support functions applicable thereto. Some of the items manufactured by the contractor have been standardized for over 25 years, but the bulk of them are relatively new and still subject to design changes requiring the utmost flexibility and responsiveness. Performance under the contract requires a comparable amount of technical expertness required by any manufacturing operation of comparable magnitude involving explosives and materials dangerous and hazardous in nature. Operation of a large ammunition loading plant such as this involves not only the staffing of existing facilities, but the establishment of criteria for the design of new structures, and the complete design, fabrication and procurement of loading and assembly equipment for new end items. Also involved is the replacement or modernization of existing equipment in order that work may be accomplished more efficiently with greater safety, economy and quality. Engineering studies and services are performed as may be requested or approved by the Government with a primary view towards a development of more efficient mass production equipment, techniques, procedures and methods. Operation of the plant also includes procurement, receipt, storage and issue of necessary supplies, equipment, components, and essential materials. Maintenance and/or repair of active facilities are in support of current operations. In addition, maintenance of layaway and standby facilities including any machinery and package lines received from industry is performed as directed. Also involved are receipt, surveillance, maintenance, renovation, demilitarization, salvage, and storage of assigned field service stocks and V&W group items of industrial stock as required or directed. Mobilization planning, including review and revision of plans, is performed as required.

(d) *Subcontracting.* None of the loading, assembly and packing operations of this plant has been subcontracted. Subcontracting in other areas has been minimal and is estimated as less than 5 percent.

(e) *The Facilities Involved* are Iowa Army Ammunition Plant (AAP), a Government-owned facility at Burlington, Iowa. The facilities consist of real estate, buildings, fixtures and production equipment, with an estimated replacement value of $66,127,638. The contractor has made effective use of these facilities.

(f) *Level of Production.* Loading, assembly, packing (L/A/P) operations in the calendar year involved the production of 40 to 45 different items, many of them new items. Nine of the 11 lines were in operation for 2 months of the year and 10 of the 11 lines were operated for the other 10 months. Most of the lines were operating on a two to three shift basis. In addition to the support activities, routine maintenance work, facilities expansion and reactivation of production lines performed by the contractor, the design, fabrication and procurement of loading and assembly equipment for new items were at a very high level.

(g) *Total Billings* (contract payments, that is costs and fees) *During Period.* $49,465,842.25.

(h) *Total Production Fees Paid to Contractor During Period.* $1,487,566.91, which is 3.1 percent of the reimbursed costs. This fee ratio is commensurate with similar GOCO contracts. No important contracts have been negotiated with this contractor without fees.

(i) *Contractor Performance.*

1. Production of accepted items has met the contract requirements.

2. Delivery schedules were generally met, and those instances of failure were a result of nonavailability of Government-furnished metal parts.

3. Rejection and spoilage rates were kept to a reasonable and acceptable level. The introduction of new items and extremely rapid expansion of production schedules with the inherent increase in training of personnel, defective metal

parts and numerous changes in specifications, caused an increase in spoilage rates.

4. The contractor has utilized materials, facilities and manpower in a satisfactory and economical manner and has been reasonably effective in controlling production costs.

5. Contracts were negotiated with all unions during 1966 for a period of 3 years. There were no strikes or work stoppages during the period of this report. Joint labor-management meetings were held monthly to discuss problems that had arisen thus providing a continuous channel of communication. Difficulties have been experienced in the recruitment of personnel due to the rapid buildup of production and production schedules and tight labor market. However, contract performance has not been affected to any substantial degree in this area.

(j) *Information Concerning Reasonableness of Costs and Profits.*

1. The adequacy and reliability of the contractor-provided cost information has been average to above average compared to other GOCO contractors.

2. Since the subject contract is a cost reimbursable type contract, the contractor assumed little if any risk.

3. There have been no significant refunds or price reductions.

4. The contractor is an average cost producer. Cost overruns were caused in most instances by unforeseen problem areas, primarily new items and additional work and changes in specifications after the original estimates and funding were provided. Cost underruns were caused primarily by rapid increase in the volume of production and the resulting decrease of overhead applied. This factor is involved in both underruns and overruns since the overhead fluctuates with the volume of production. Another cause for overruns and underruns is inaccurate estimates for the new items for which no prior experience or historical data is available.

5. The contractor operates with approximately $20,000 of company funds as plant working capital. The Government locally reimburses the contractor concurrent with release of payments checks that the contractor has issued.

(k) *Contractor's Contribution to Defense Efforts.*

1. The contractor has made a contribution to the defense effort by virtue of his operation of this plant by producing acceptable ammunition and ammunition components for the Armed Forces. He has made effective use of Value Engineering validated cost reduction savings in the amount $275,700 for calendar year 1967.

2. The contractor's overall performance for the period under consideration has been most satisfactory.

3. Many new items have been introduced during this period and the contractor has been flexible and most responsive to the numerous changes in specifications and design which have occurred as well as the rapid build-up in production schedules. The contractor excels in the area of design and operation of equipment for the manufacture of extremely high quality explosive castings. The contractor has pioneered in the design of vacuum melting and pouring equipment for loading ammunition items where density and soundness of cast is of the utmost importance. Total production fees paid to the contractor for calendar year 1967 were $1,487,566.91 which is 3.1 percent of the reimbursed costs.

**12.** Plaintiff was not only the "major supplier of high explosive bombs to the Air Force" (finding 10(k)), but also the only producer of the 750-pound bomb and an antipersonnel aerial mine, involving a particularly sensitive explosive, under a program which was new in 1967 and had the highest priority. Production of the aerial mine was undertaken after other contractors had declined to take the project on, and, in terms of costs and fees, the aerial mine project accounted for approximately 20 percent of work in 1967 at the Iowa plant. Nine million of these mines were produced by plaintiff in 1967 and plaintiff was congratulated by the Army Munitions Command for its performance.

**13.** Plaintiff, in the year under review, cooperated with the Government in respect to additional work under the contract and assistance to other Government contractors and to foreign governments. When the Government failed timely to supply wooden pallets on which bombs are shipped, plaintiff manufactured large numbers of pallets at the Cornhusker plant so that deliveries could be made on schedule. At the Army's request, plaintiff gave technical assistance to other

GOCO contractors in matters with which plaintiff was familiar. Similarly, plaintiff gave assistance to the governments of the Netherlands, Australia, Canada and Great Britain.

14. The Burlington AEC plant is contained within the perimeter of the Iowa Army plant; together they occupy a tract of 19,136 acres, on which there are 1,042 buildings, with 4,000,000 sq. ft. of floor space. The tract contains 150 miles of roads and 102 miles of railroad.

The other AEC plant, the Pantex plant, covers 10,200 acres on which there are 80 buildings with 700,000 sq. ft. of floor space and 26 miles of roads.

The Cornhusker Army plant covers 11,983 acres, on which there are 649 buildings, with 2,300,000 sq. ft. of floor space, 88 miles of roads and 28 miles of railroad.

15. In 1967 the work force at the four plants averaged over 11,000. The following were the categories of employees.

| | *Employees* |
|---|---|
| Officials and managers | 385 |
| Professional | 363 |
| Technicians | 667 |
| Office and clerical | 866 |
| Craftsmen (skilled) | 2, 055 |
| Operatives (semi-skilled) | 5, 635 |
| Laborers (unskilled) | 604 |
| Service workers | 618 |
| Total | 11, 193 |

The 363 professionals included 151 engineers, 33 chemists and biologists and 32 physicists and mathematicians. The engineering fields represented were civil, architectural and structural, 16; mechanical, 53; electrical, 16; chemical, 27; and industrial and quality control, 39.

16. (a) Plaintiff's surplus, total assets and net worth at the beginning of 1967 were, respectively, $5,679,369.27, $6,311,624.71 and $6,012,369.27. Most of the surplus was invested in stock, Treasury bills and certificates of deposit.

(b) Because of the nature of plaintiff's business as a GOCO contractor, the prompt reimbursement of costs, and the payment of fees at short intervals, performance of plaintiff's contracts did not require it to use substantial amounts of its own funds for extended periods of time. Plaintiff operates with a small amount of cash at both the Army and the AEC plants as plant working capital.

17. (a) The Government reimbursed plaintiff for costs at the Army plants weekly, though the contract required only monthly reimbursement. Costs at the AEC plant were prefinanced by a letter of credit on which plaintiff drew as it issued checks.

(b) Reimbursement takes place so often, in the case of the Army contracts more often than the contract requires, in furtherance of the concept of GOCO contracting, under which capital investment by the contractor is intended to be reduced to the minimum.

18. (a) The possibility, in 1967, by reason of Government studies and proposals since 1952, that the Government would reimburse GOCO contractors less often than weekly, did not mature into actuality until 1972, when the Army changed its reimbursement frequency from weekly to biweekly, and paid compensation for the additional contractor capital required, according to a formula paying an additional fee for the financing of the operation.

(b) Plaintiff had no need in 1967 for the maintenance of any substantial capital as a reserve for the possibility that the Army might reimburse GOCO contractors less often than it did. Any problem which might be presented by a less frequent reimbursement schedule would be solvable by borrowing, with the reasonable expectation that compensation would be paid for the additional working capital required.

19. Plaintiff's home office in Lexington, Kentucky, almost entirely devoted to its renegotiable business, is headed by a chairman, president and executive vice-president who together own 88 percent of plaintiff's stock and are paid total salaries of $225,000.

The plant managers at the GOCO plants report to the chief engineer and vice-president in charge of operations (a lesser officer than the officers mentioned above) at the home office. The home office establishes high-level corporate policy in such areas as personnel and labor relations, negotiates Government contracts and amendments thereto, participates in labor relations and the negotiation of union contracts, and assists the individual plants with engineering services, engineering designs, and advice on safety and in areas such as equal opportunity and small business participation programs.

20. The Government's policy is not to reimburse GOCO contractors for home office general and administrative costs (unless specific work is assigned to the home office, in which case its cost is reimbursed) because GOCO plants are generally structured and staffed so as to operate with little or no dependence on the home office, and in the case of those who (unlike plaintiff) have substantial non-GOCO business, the home office might neglect GOCO for other business, making the GOCO business share of the expense disproportionately large.

Accordingly, plaintiff's contracts do not provide for reimbursement of such expenses. Instead the Army accepts billing for home office costs directly incurred at a GOCO plant, and also, in fixing fees, considers the fact that home office is not being reimbursed.

The costs of plaintiff's home office (including other non-reimbursed costs of approximately $30,000) were $822,000 in 1967 (and $755,000 in 1966). These costs were deducted from the fixed fees in determining profits subject to renegotiation. The renegotiable profits presently under review are thus net after deduction of home office costs and other non-reimbursed costs.

21. An allocation of plaintiff's home office expenses to its GOCO business as a cost (which plaintiff contends would bring down its profit ratio) is not permissible under the contracts and has not been an issue in the pretrial of this case. The amount of renegotiable sales and profits has, moreover, been agreed; and thus their percentage relationship or ratio is fixed.

22. The risk of explosion, despite plaintiff's technical expertise, long experience and training programs, is ever present in plaintiff's work of dealing with high explosives and packing of ammunition.

A bomb manufactured by plaintiff exploded in 1967 in the Port of Chicago, and injured a fork-lift operator. There have been two major explosions in the aerial mine program (one occurring in 1967) in which nine employees were killed.

23. The Army contracts provide that because of the hazardous nature of the work and the risks involved, the Government will indemnify plaintiff for all losses arising out of the performance of the work, including personal injuries and deaths, unless caused by bad faith or willful misconduct of a corporate officer or a representative in charge of the whole business or a whole plant acting within the scope of his authority.

24. Under the AEC contracts, plaintiff was indemnified by the AEC for losses resulting from nuclear incidents in the United States to the extent of $500 million, and outside the United States to the extent of $100 million.

When in 1967 the exposure from nonnuclear incidents was estimated to be $100 million in one plant and $125 million in the other, and the premium for insurance to be $550,000, the AEC decided to provide an indemnification for nonnuclear incidents, and it did so in 1968.

In 1967, plaintiff could, however, reasonably rely, for indemnification for nonnuclear incidents, upon the AEC contract provision authorizing reimbursement for "just and reasonable" expenses and losses in the performance of the contract.

25. During the entire time plaintiff has had GOCO contracts, since 1958, it has never failed to be reimbursed for the claims paid or losses incurred by reason of explosions or for claims resulting from accidents causing injury or death. Plaintiff has borne, from such causes, only some nonreimbursed home office expenses. There are some claims now pending, but there is no reason to believe that losses and settlements will not continue to be reimbursed.

26. Plaintiff does not incure any appreciable financial risk from the possibility of explosions. It does not employ or need its capital as a reserve for such risks, and it was not required to maintain substantial capital, in 1967, on account of such risks.

27. (a) Financial risks to plaintiff from causes other than explosion were also minimal.

(b) While the value of Government-owned property entrusted to plaintiff was high, the financial risk to plaintiff from loss or destruction of Government-furnished property was negligible. The indemnification for plaintiff's losses, except for misconduct by high-level management, includes losses of Government-furnished property. Plaintiff's witnesses could remember, hazily, only one item of property, lost "years ago," for which plaintiff was ultimately held responsible.

Plaintiff was not required to maintain any substantial capital on account of any risk of loss of Government-furnished property.

(c) In 1967 there were no strikes or stoppages, or other significant developments in labor-management relations affecting contractor's performance at the Army plants.

Data on this subject for the AEC plants does not appear in the record.

The risk of financial loss in 1967 in connection with strikes or other expressions of bad labor relations was negligible. The "risk" that should there be a strike, the work done at plaintiff's plant would be done elsewhere is not a risk in any way unusual in a business.

(d) The "risk" that a contract such as plaintiff's GOCO contracts may be terminated for convenience is no more a risk than that it may come to an end by expiration. The work of an ammunition plant ends, naturally, when ammunition is no longer needed. Plaintiff is reimbursed for all costs, on either a termination for convenience or on expiration.

(e) Nor is it a "risk" that upon termination, for whatever reason, plaintiff may find it difficult to return to, or enter other business than its GOCO business. Plaintiff could enter such other business at any time, employing for it the capital it does not use in the instant business.

(f) Fees paid to plaintiff by APSA in 1967 were based on the assumption that plaintiff's risks were minimal.

28. Plaintiff possessed, in 1967, very substantial technical and scientific expertise and know-how, enabling it to perform the technical, complex, highly responsible operations and for its personnel hazardous work involved in the operation of the four plants to produce satisfactorily the nuclear and non-nuclear ammunition of the type and quality and in the quantity required by the Government. While the expertise and know-how was during 1967 doubtlessly valuable, in non-

balance-sheet terms, there is no evidence in the record upon which to base a valuation of it, for inclusion in the capital devoted to the business or otherwise.

**29.** (a) Plaintiff's gross income from sales, renegotiable and negotiable, in 1962–1966 was as follows:

| | *Gross income* |
|---|---|
| 1962 | $41, 282, 276. 45 |
| 1963 | 39, 445, 883. 91 |
| 1964 | 40, 748, 260. 31 |
| 1965 | 39, 503, 465. 09 |
| 1966 | 63, 202, 837. 91 |

(b) Renegotiable receipts, profits and profits expressed as a percentage of receipts (profit ratios) in the 3 years 1965, 1966 and 1967 were:

| | *Receipts* | *Profits* | *Ratio* |
|---|---|---|---|
| 1965 | $39, 041, 000 | $647, 000 | 1. 66 |
| 1966 | 62, 774, 000 | 1, 122, 000 | 1. 79 |
| 1967 | 112, 931, 000 | 2, 681, 000 | 2. 37 |

Profits in 1965 and 1966 were found by the Renegotiation Board to be nonexcessive. On the $50.1 million excess of receipts in 1967 over the $62.8 million of receipts in 1966, plaintiff made profits of $1.5 million more than the $1.1 million in profits on the first $62.8 million in receipts.

(c) Plaintiff's nonreimbursable costs, comprised of its home office expenses and certain corporate costs, were $755,000 in 1966 and in 1967 increased by $67,000 to $822,000.

(d) Percentage increases of receipts, profits and profit ratios were as follows:

| | *1966 Percentage Increase Over 1965 (equal to average of 1962–65)* | *1967 Percentage Increase* | |
|---|---|---|---|
| | | *Over 1965* | *Over 1966* |
| Renegotiable receipts | 60. 79 | 189. 26 | 79. 9 |
| Renegotiable profits | 73. 42 | 314. 37 | 138. 95 |
| Profit ratios | 7. 83 | 42. 77 | 32. 4 |

(e) The percentage increase in nonreimbursable costs from 1966 to 1967—$755,000 to $822,000—was 8.87 percent.

**30.** From the beginning in 1965 of the intensified American participation in the war in Vietnam and as the "heating-up" of the war continued in 1966 and 1967, the Army procurement authorities had sought to encourage increased capability and production of the type of ammunition produced in plaintiff's Army plants, and, having achieved high-level production, to keep and encourage the high level. They were interested in "getting the goods" and bought all that could be produced.

31. In 1965, 1966, and 1967, plaintiff's employees totaled 5,300, 6,900 and 11,200 , respectively. In 1965 there were seven production lines in operation at the Iowa plant, in 1966 nine production lines, and through most of 1967 ten (of a total of 11) production lines. In 1967 Iowa was producing 40 to 45 different items, 11 of which were in the developmental stage. Many of the 40 to 45 items were new items. The Cornhusker plant had been "mothballed" until late 1965 when it was reactivated. Production at Cornhusker began in January 1966 and increased throughout the year. In 1967 the Cornhusker plant was operated near capacity.

32. The customary method by which an order was placed with an Army GOCO plant, in effect in 1967 and previously, was that the Government, when it had need for an item of ammunition produced by or capable of being produced by a GOCO contractor, solicited from the contractor as estimate of cost, to be based on a gross production amount and an idea as to a production rate.

In keeping with the objective stated above in finding 30, and since all of the GOCO contractors in plaintiff's field were being used to their limit, competitive estimates of cost were not solicited in 1967.

The estimate was reviewed and refined by APSA's staff at the plant and ultimately reviewed and approved at APSA.

33. Following approval of the cost estimate, a fee per unit to be produced was negotiated, and upon approval of the cost estimate and agreement on the unit fee, the order was embodied in an amendment to the contract. Then, monthly, APSA put out a schedule of how many units or rounds it would require for an extended period of a year, or more or less.

34. APSA's guidelines for establishing the fee per unit of ammunition to be produced by a GOCO producer included the estimated cost of the item, the scope of the work required to produce the item, in terms of complexity of work rather than its cost; the profit objectives "weighted guidelines" of the Armed Service Procurement Regulations, used by the Army in dealing with private plants and modified by APSA

for purposes of GOCO plants; the unit fee paid on a prior order of the same item, or the fee paid to other contractors producing the same item, if it was or had been in production or, if not, the unit fee paid for items similar in character to the item for which the fee was being established; the total volume of work being performed by the contractor; the contractor's total fee return; and the character and extent of the contractor's nonproduction, nonfee bearing activities.

**35.** In practice, fees were actually freshly discussed and negotiated only in cases of experimental, new or pilot lots, in cases where the first production run was being ordered following a small pilot lot order, and in cases where changes in technology had lowered costs to a point where the fee was no longer relevant. There were about 12 such negotiations in 1967.

Except in the foregoing cases—described in the record as unusual—repeat orders were placed at previously established fees. Most orders were repeat orders. There were about 100 repeat orders to plaintiff in 1967.

The reasons for placing repeat orders at previously fixed fees are indicated in finding 31, above, and 40, below.

**36.** For the same reasons that repeat orders were placed at previously set fees (finding 35), the same unit fee was with rare exceptions paid to all the contractors who were producing an item.

**37.** The largest part of the fees paid for production in 1967 were, moreover, originally set on a basis of requirements given to the contracting officer by others in the Army, at a time when there was no anticipation of a long war or of a long production run of the items required. The assumptions were a short war and a limited volume.

The assumptions turned out to be wrong. The war continued longer than anticipated, and volume of orders rose beyond expectations.

**38.** There was no reduction, or consideration of reduction, in fees on the ground of the expanded and increasing volume of orders, on any other related ground or on any ground except to the extent indicated in finding 35. APSA never requested plaintiff to reduce fees on repeat orders on the ground that increased quantities were being ordered.

**39.** Once a fee on an item was set by APSA it would remain in force indefinitely, though reimbursable costs of production went up or down. For example, the unit fee per 175-mm. projectile remained steady at the Iowa plant for 6 years beginning in 1966 at $0.27 per unit, though reimbursable costs varied substantially, up and down, as shown in the following table:

Iowa Army Ammunition Plant
L/A/P Projectile, 175 mm, HE, M437A2

| *Fiscal Year* | *Date* | *Quantity* | *Rate* | *Unit Cost* | *Fixed Fee* | *Percentage** |
|---|---|---|---|---|---|---|
| 1966 | 16 Sep 65 | 505,000 | 40,000 | 8,338 | 0.27 | 3.35 (3.24) |
| 1967 | 19 Oct 66 | 111,000 | 27,000 | 7,724 | 0.27 | 3.62 (3.50) |
| 1968 | 21 Aug 67 | 485,000 | 60,000 | 6,904 | 0.27 | 4.07 (3.91) |
| 1969 | 13 Aug 68 | 833,000 | 90,000 | 5,683 | 0.27 | 4.99 (4.75) |
| 1970 | 21 Nov 69 | 173,000 | 60,000 | 7,694 | 0.27 | 3.64 (3.51) |

*The percentages above, not in parentheses, are erroneous, but are given as they appear in an exhibit in evidence. The percentages in parentheses are correct.

**40.** APSA, far more interested in increasing production than in reducing fees or in promoting competition in fees, did not wish to undertake negotiations for fees on repeat orders. Indeed, one of the reasons for the adoption of the unit fee system was that it would obviate the need for such negotiations.

Fees earned by plaintiff in 1967, whether on repeat orders placed in that year or placed in the previous year and filled in 1967, were the previously established fees, agreed to as a routine matter, without bargaining or competition.

**41.** The contracting officer on plaintiff's APSA contracts was a man of many years' experience in negotiating fees which he and APSA considered proper. He was aware, throughout, of plaintiff's production level and overall fees and profit rate, and aware, too, that in 1967, 1968 and 1969, when production was building up, the rate of profits of GOCO contractors was rising. He and his colleagues, knowing this, would try to cut down overall fees of GOCO contractors by negotiating fees downwards on repeat orders when they had risen above the proper "historical" margin of profit, which he and his colleagues felt was about 3 percent. (Compare the data for 1966 and 1967 in findings 43–44.) He could not remember doing this with plaintiff, from which, he agreed, it could be inferred that he (and thus, presumably, his agency) did not feel plaintiff was getting up above the proper margin of profit.

42. Plaintiff did not request increases in unit production fees in 1967, either on the ground of an increase in hazards from larger-scale work with high explosives, a rise in training costs as production costs rose, or other ground.

43. (a) Profit data for DOD, AEC and NASA GOCO plants and service contractors whose source is *Defense Industry Profit Study*, Report No. B–159896, to Congress by the Comptroller General, March 17, 1971 (pp. 29, 73), is set out in following subparagraphs (b) and (c).

(b)

> *Profit data for GOCO plants and service contracts of 80 large DOD contractors*
>
> We obtained separate data pertaining to the operation of GOCO plants, contracts for operation and/or maintenance of Government facilities, and service contracts for DOD and the other defense agencies (NASA and AEC). The characteristic common to these contracts is that they require little or no investment of contractor capital. If we included data on these contracts, our overall profit data would be distorted.
>
> Of the 80 large DOD contractors, six reported all, or practically all, their defense business in GOCO-type sales, and 38 others reported some sales of this type to DOD or other defense agencies. The volume of GOCO business reported was about 2½ times greater for DOD than for the other defense agencies ($2.1 billion and $0.8 billion, respectively). The profit on sales for the other defense agency business was about 32 percent higher than for DOD business (4.1 percent and 3.1 percent, respectively).
>
> The difference in profit between DOD and the other defense agencies on GOCO sales may be explained, in part, by the nature of the work performed. The bulk of GOCO sales to DOD were for the operation of Government-owned ammunition plants and to NASA were largely for technical services. GOCO sales to AEC were divided between support services and GOCO plant operations. Cost-type contracts were the contracts most widely used by both DOD and other defense agencies for this work.
>
> **(For further details see sch. 15 [set out in the following subparagraph (c)].)**

(c)

*Schedule 15*

Summary of Sales and Profits Before Federal Income Taxes for GOCO Plants and Service Contracts of Large DOD Contractors

| | *1966* | *1967* | *1968* | *1969* | *Weighted Average* |
|---|---|---|---|---|---|
| *GOCO Sales* (in billions) | | | | | |
| DOD | $1.7 | $1.9 | $2.3 | $2.5 | $2.1 |
| Other defense agencies | 0.7 | 0.8 | 0.8 | 0.8 | 0.8 |
| *Profit as Percent of Sales* | | | | | |
| DOD | 2.5% | 3.1% | 3.3% | 3.3% | 3.1% |
| Other defense agencies | 4.3 | 4.6 | 4.2 | 3.3 | 4.1 |

**44.** (a) Profit data for DOD GOCO ammunition plants for 1967–71, obtained from the Department of Defense, OASD (Comptroller), Directorate for Information Operations, is set out in following subparagraph (b).

(b)

Summary of Average Profits on Department of Defense Government-Owned-Contractor Operated (GOCO) Ammunition Plants

(Fiscal Years 1967 through 1971)

| *Fiscal Year* | *Number of Contracts* | *Cost ($ Thousands)* | *Profit ($ Thousands)* | *Average Profit Pct. on Cost* | *Profit Range* | |
|---|---|---|---|---|---|---|
| | | | | | *High* | *Low* |
| 1967 | 34 | $530,917 | $16,537 | 3.1% | 6.7% | 1.7% |
| 1968 | 24 | 1,493,240 | 47,492 | 3.2 | 5.6 | 0.9 |
| 1969 | 37 | 2,044,665 | 68,484 | 3.3 | 8.0 | 1.5 |
| 1970 | 40 | 1,045,990 | 35,341 | 3.4 | 8.2 | 1.2 |
| 1971 | 38 | 880,563 | 29,511 | 3.3 | 9.1 | 0.4 |
| Totals | 173 | $5,995,375 | $197,365 | 3.3% | | |

(c) It may be inferred from the similarity of the DOD groups reported on by the Comptroller General (mainly ammunition plants) (finding 43(b)) and in the present finding (exclusively ammunition plants) and from the identity of their average profit ratios in 1967–69, that the average profit ratio in 1966 of the group reported on in the present finding was the same 2.5 percent as is reported by the Comptroller General in finding 43(c).

**45.** (a) It may be inferred that each of the contracts noted in the second column of the table in the foregoing finding covered one plant, and thus that the figures for 1967 represent 34 plants.

(b) The total reimbursed costs of $530 million for the 34 plants, divided by 34, gives an average per plant of less than $16 million reimbursed costs, far less than either the reimbursed costs of $34 million and $49 million at Cornhusker and Iowa, respectively. Many of the 34 plants, if not most, were thus much smaller than the Army plants operated by plaintiff. The DOD average is, therefore, based on data for plants much smaller than the plants operated by plaintiff.

(c) The record does not contain details on the nature of the business, efficiency, or contribution to the war effort of the 32 plants other than plaintiff's.

**46.** During 1967, Federal Cartridge Corp., under a GOCO contract with the Army, operated the Twin Cities Army Ammunition Plant, at which it produced two small-arms ammunition items. The Twin Cities plant was Federal Cartridge's sole GOCO operation; the negotiable sales from the plant in 1967 were $74.6 million. Federal Cartridge's renegotiable profit for 1967, expressed as a percentage of sales, was 3.1 percent. After renegotiation, its profits were 2.7 percent of sales.

There is no evidence in the record of the company's efficiency or contribution to the defense effort.

**47.** (a) Dr. William Long testified as an expert witness for the Government. Dr. Long is an associate dean at George Washington University and teaches economics. He received his Doctorate in economics from that institution. He is a member of several societies, including the American Economic Association. He was at one time chief economist for the Electronic Industries Association, in which capacity he represented some 540 companies before various congressional committees. His function was to examine the economic-production-marketing aspects of those companies and to prepare data and testimony on their behalf.

(b) Dr. Long testified that in his opinion plaintiff incurred no risk to its capital. He also testified that in his opinion plaintiff's profits were disproportionately high in 1967, because, while plaintiff's sales from 1966 to 1967 did not quite double, its profits more than doubled. He stated that a reasonable profit for plaintiff in 1967 would have been $2,130,000, or at most $2,244,000.

## CONCLUSION OF LAW

Upon the foregoing findings of fact and for the reasons given in the opinion, the court concludes and determines as a matter of law that plaintiff realized excessive profits in the gross amount of $423,000 from contracts or subcontracts subject to renegotiation under the Renegotiation Act of 1951, as amended. Plaintiff's petition is hereby dismissed and judgment is entered on defendant's counterclaim in the sum of four hundred twenty-three thousand dollars ($423,000) less appropriate state and federal tax credits, plus interest thereon as provided by law.

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**523 F. 2d 1384**

ORDER ON PLAINTIFF'S MOTION FOR RECONSIDERATION

October 3, 1975

"This renegotiation case comes once again before the court, presently on plaintiff's motion for reconsideration and additional trial on certain issues which figured in our decision announced June 25, 1975. Briefly, plaintiff would have us vacate the judgment and remand the case to the Trial Division for further evidentiary hearing on two points: (1) whether 1965 presents an appropriate historical base for purposes of evaluating 'normal earnings,' 50 U.S.C. APP. § 1213(e)(1) (1970); and (2) whether in principle renegotiable profit rate should be thought to decline as sales increase in this line of business. On August 14, 1975, the court allowed the motion of John T. Koehler and Judith A. Yannello for leave to file a brief *amicus curiae* directed to the matters raised by the instant motion. Upon a thorough review of the record and briefs, we conclude that the plaintiff has not demonstrated adequate grounds for the extraordinary relief sought and that the motion must be denied.

"In *General Elec. Co.* v. *United States*, 189 Ct. Cl. 116, 416 F. 2d 1320 (1969), we considered the standard by reference to which a motion for reconsideration will be evaluated. We recognized that a request for such relief must be received hospitably where the decision has turned upon a point neither briefed nor raised by the parties. A contrary rule applies in the normal case, however:

> * * * where a party adversely affected by the court's decision on the issue has had fair notice that the question may well be in the case, has had a fair chance to present its position, has failed to do so, and gives no

> sufficient excuse for its failure, a demand for post-decision relief will normally be rejected. * * *. [189 Ct. Cl. at 117–18, 416 F. 2d at 1321–322.]

We think this rule fully applicable here.

"Plaintiff tells us that since the Government bears the ultimate burden of proof in this case under *Lykes Bros. S.S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972), and since the Government at trial did not specifically rely on 1965 profits or on the familiar volume principle, plantiff was not properly put to its proof on either point. We do not agree.

"With respect to 1965 profits as normal earnings, our examination of the transcript indicates that defense counsel's prepared questions for its expert witness, a copy of which was provided for opposing counsel before trial, included an inquiry specifically directed to 1965. Without objection defendant introduced in evidence a summary of plaintiff's profit position for the years 1962 through 1966, inclusive. On cross-examination defendant's expert testified that in his opinion profits as a percentage of sales remained fairly constant during this period, and that any of the years referenced could usefully be considered as a benchmark for evaluating earnings in 1967. In these circumstances, and particularly in view of the explicit wording of 50 U.S.C. APP. § 1213(e) (1) (1970), we find that at the trial level plaintiff had notice that 1965 earnings could be taken into account. Plaintiff could have adduced rebuttal evidence on this point at the trial, yet for reasons of its own it did not.

"The 'volume principle,' codified in 32 C.F.R. § 1460.10(b) (3) (1971), also found its way into this litigation at the trial level. Plaintiff's counsel elicited testimony to the effect that under "unusual circumstances" unit fees would be reduced; for example, as in the case of full production runs of ordnance previously fabricated only in much smaller pilot lots. Counsel inquired of his witness whether or not the Government had ever asked plaintiff to reduce fees because of larger quantities. Defendant's expert testified at some length respecting the profit-to-sales ratio. This line of questioning indicates notice that the volume concept was in the case, whether technically brought up by defendant in its evidentiary presentation or in the trial briefs. Moreover, the trial judge was required by law to take judicial notice of the content of 32 C.F.R. § 1460(b)(3) (1971). 44 U.S.C. § 1507 (1970). We think that plaintiff was clearly on notice of the presence of this issue at trial. We are not inclined to provide an opportunity for post-decision bolstering of contentions which we have already rejected. *See Carchia* v. *United States*, 202 Ct. Cl. 723, 731–32, 485 F. 2d 622, 626–27 (1973).

"The *amicus* brief raises two matters which merit further comment. First, Mr. Koehler suggests that we delete our citation of his remarks since they were made only with reference to firm fixed-price contracts. We note that he made no distinction between contracts of that species and those of the cost-plus-fixed-free variety at the time of his speech. Moreover, 32 C.F.R. § 1460.10(b)(3) (1971) makes no such distinction. Second, our opinion specifically disclaims reliance on any single fact or factor as a rigid formula or fixed limitation on allowable profit. Normal earnings were but one of several factors entering our judgment, and we reiterate that view here. With due respect, plaintiff and amici misapprehend the thrust of the opinion.

"IT IS THEREFORE ORDERED that, upon reconsideration of the entire record, without oral argument, plaintiff's motion for reconsideration and additional trial is denied."

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518 F. 2d 1202

# MANUFACTURERS SERVICE COMPANY, INC. v. THE UNITED STATES

[No. 336-74. Decided June 25, 1975]

## ON DEFENDANT'S MOTION FOR JUDGMENT IN AID OF EXECUTION OF THE RENEGOTIATION ORDERS OF JUNE 25, 1974

**Renegotiation of contracts; redetermination of excessive profits; sufficiency of bond to stay execution of order of Renegotiation Board.**—This is a suit for redetermination of the amount of excessive profits found by the Renegotiation Board. Plaintiff, desiring to stay execution of the order of the Board, tendered to the court bonds approximating 70% of the net excessive profits to be eliminated under the Board's orders and moved for waiver of Rule 26(b) and for leave to file bond in lesser amount. Defendant opposes the motion and filed a motion for judgment in aid of execution of the Board's orders. The issue now considered by the court is whether the filing of a bond in an amount less than 100% of the net excessive profits determined by the Board is sufficient to stay execution of the Board's orders during *de novo* redetermination in this court. It is *held* that the 100% bond requirement of Rule 26(b) provides the protection Congress intended and is sufficient to comply with the congressional mandate of 50 U.S.C. App. § 1218; that the court, having fixed the required amount at 100%, is prohibited by Congress from considering the proffer of a lesser percentage; that by limiting the time period for filing the bond Congress implicitly precluded a case-by-case determination of what constitutes the "good and sufficient" bond requirement of Sec. 1218; that Rule 26(e) merely provides a mechanism for adjusting the *dollar* amount of an already filed 100% bond where changed circumstances dictate such an alteration; that plaintiff's tender of less than a 100% bond does not comply with Rule 26; and that where a 100% bond is not timely filed the Government possesses an immediate right to seek a judgment in aid of execution. Defendant's motion for judgment in aid of execution of the Board's orders is granted and judgment is entered for $213,984.29 with interest as provided by law.

**Renegotiation of contracts; Renegotiation Act; construction and operation; redetermination v. collection functions.**

[1] From the inception of the redetermination provision under the first Renegotiation Act, the total separation of the redetermination and collection functions clearly reflected a congressional intent to structure judicial redetermination utilizing a collect now, litigate later technique, and this technique has been carried over to judicial redetermination in the Court of Claims, although Congress now permits a stay of execution of an order of the Renegotiation Board but only upon the timely filing of a good and sufficient bond approved by this court.

**War and National Defense ⚿ 59**

**Renegotiation of contracts; pleading and practice; bond to stay execution of order of Renegotiation Board.**

[2] A 100% surety or collateral bond has been fixed by the court as being "good and sufficient" to stay execution of an order of the Renegotiation Board determining the amount of excessive profits realized by a contractor (Rule 26(b)).

**War and National Defense ⚿ 59**

**Renegotiation of contracts; Renegotiation Act; construction and operation; legislative intent; execution of order of Renegotiation Board.**

[3] Congress, in providing for the immediate execution of an order of the Renegotiation Board determining the amount of excessive profits realized by a contractor, intended to insure the protection of

the Government's interest against the dissipation of a contractor's assets during pendency of litigation, and in permitting a stay of execution and designating a bond "in such amount as may be fixed by the court" Congress intended to allow this court to decide if a 100% bond was sufficient to provide the same security as would the execution of a judgment.

War and National Defense ⊂⊃ 59

**Renegotiation of contracts; pleading and practice; bond to stay execution of order of Renegotiation Board.**

[4] Once this court fixed the required bond amount at 100%, Congress prohibits the court from even considering the proffer of a lesser percentage. Thus, Rule 26(e), rather than authorizing this court to tailor the bond to an individual plaintiff at its original filing, merely provides a mechanism for adjusting the *dollar* amount of an already filed bond where changed circumstances dictate such an alteration. Such alteration is permitted only after the initial filing of a 100% bond and only in those situations where one of the parties makes a showing that such adjustment is necessary to maintain the 100% equilibrium; otherwise, the 10-day limitation for filing the bond would be meaningless.

War and National Defense ⊂⊃ 59

**Renegotiation of contracts; pleading and practice; judgment in aid of execution of order of Renegotiation Board.**

[5] Absent some compelling showing of unusual or mitigating circumstances excusing the untimely filing of a 100% bond pursuant to Rule 26, the Government possesses an immediate right to seek a judgment in aid of execution of an order of the Renegotiation Board determining the amount of excessive profits realized by a contractor. The court presumes that the Government will act in good faith and in the public interest in seeking such judgment, since it is the Government's responsibility to use the judgment wisely.

War and National Defense ⊂⊃ 59

*Nelson L. Bain*, for plaintiff; *Loren K. Olson*, attorney of record. *Morgan, Lewis & Bockius*, of counsel.

*Howard G. Slavit*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

The question here at issue is whether the filing of a bond in an amount less than 100 percent of the net excessive profits[1] found by the Renegotiation Board (Board) is sufficient to stay the execution of the Board's order during *de novo* redetermination in this court. A similar issue is presented in *Bannercraft Clothing Co., Inc.* v. *United States*, *post* at 199, 518 F. 2d 605 (1975). We hold that execution of the Board's order is stayed only by the filing of a 100 percent bond.

Plaintiff[2] filed its petition in this court on September 17, 1974 for a redetermination of excessive profits for fiscal years 1967,[3] 1968,[4] and 1969,[5] under Section 108 of the Renegotiation Act of 1951, 50 U.S.C. App. § 1218, *as amended* (Supp. II, 1972). Its renegotiable sales, according to the petition, were $5,655,467[6] and its renegotiable profit was $981,957,[7] of which the Board determined that $418,279 was excessive.[8] Federal tax credits for the years at issue were determined by the Internal Revenue Service to be $204,294.71,[9] leaving the Board's determination of net excessive profits at $213,984.29.[10]

---

[1] Net excessive profits are the excessive profits found by the Renegotiation Board less appropriate tax credits. Before issuing an order, the Board adjusts the excessive profit computation to reflect allowable credit for any taxes measured by income, exclusive of Federal income taxes. A further credit for Federal income taxes is computed by the Internal Revenue Service subsequent to the Board's order. In computing the amount of the bond to be filed in order to stay the execution of the Board's order, our court rules require 100 percent of the net amount owed. Where the Internal Revenue Service has not yet determined the exact amount of the Federal tax credit, this court will accept plaintiff's good faith estimate of the offset, subject to modification when the actual figures are known. *See* text at pages 191–93 *infra* where CT. CL. R. 26(e) is discussed.

[2] Plaintiff commenced business in 1956; became a partnership in 1959; was incorporated pursuant to the laws of Wisconsin on November 11, 1967; and was dissolved by resolution of the shareholders effective January 31, 1970.

[3] Fiscal year 1967 commenced January 1, 1967 and ended November 11, 1967. The ending date corresponds to the date of incorporation. Plaintiff was thus a partnership for fiscal year 1967.

[4] Fiscal year 1968 commenced November 12, 1967 and ended May 31, 1968. Plaintiff was first treated as a corporation for fiscal year 1968.

[5] Fiscal year 1969 commenced June 1, 1968 and ended May 31, 1969.

[6] Renegotiable sales for each component year were as follows:

FY 1967—$1,798,179
FY 1968—$1,395,819
FY 1969—$2,461,469

[7] Renegotiable profit for each component year was as follows:

FY 1967—$304,105
FY 1968—$278,130
FY 1969—$399,722

[8] Annual excessive profits, adjusted for taxes measured by income, other than Federal taxes, were as follows:

FY 1967—$110,699
FY 1968—$145,862
FY 1969—$161,718

On September 27, 1974, ten days after filing its petition, plaintiff tendered to the court bonds in the amount of $150,000, approximately 70 percent of the net amount of the Board's orders. Accompanying the bond was a motion for waiver of CT. CL. R. 26(b) and for leave to file bond in lesser amount. Defendant filed its opposition to plaintiff's motion on October 3, 1974 and, on November 7, 1974, filed the present motion for judgment in aid of execution of the Board's orders,[11] the single issue now before this court.

Plaintiff's opposition to defendant's motion is grounded on the same arguments presented to Trial Judge White in plaintiff's motion for waiver of CT. CL. R. 26(b) and accompanying request to file bond in lesser amount. It is plaintiff's position that this court has discretion to determine the amount of bond needed to stay execution of a Board order; that a trial judge, under CT. CL. R. 26(e) has the authority to enter an order permitting the acceptance of bonds in an amount less than 100 percent; and that the court has the authority to waive the 100 percent provision of CT. CL. R. 26(b).

Defendant, on the other hand, argues to the opposite effect, submitting that acceptance of a bond in an amount less than 100 percent would run directly counter to Congressional intent and be highly prejudicial to the interests of the Government. Defendant asserts that CT. CL. R. 26(e) must be construed consistently with both the language of the Renegotiation Act itself and with the 100 percent requirement of CT. CL. R. 26(b). For the reasons stated below, we hold for defendant.

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[9] Federal tax credit for each component year as determined by the Internal Revenue Service was as follows:

FY 1967—$43,625.47
FY 1968—$75,282.12
FY 1969—$85,387.12

[10] Net excess profits found by the Renegotiation Board adjusted for Federal tax credit for each component year were as follows:

FY 1967—$67,073.53
FY 1968—$70,579.88
FY 1969—$76,330.88

[11] On November 18, 1974, Senior Trial Judge White denied, without prejudice, plaintiff's September 27, 1974 motion and stated, "the matter will be determined by court on defendant's motion filed November 7, 1974."

Congress enacted the first Renegotiation Act (Act of April 28, 1942, ch. 247 §§ 401 et seq., 56 Stat. 245) during World War II. This first enactment contained no provision for judicial redetermination. Recognizing the unfairness of denying recourse from an adverse determination by the Board, Congress amended this Act two years later (Act of Feb. 25, 1944, ch. 63, § 701, 58 Stat. 78), allowing redetermination in the Tax Court. However, the 1944 amendment specifically stated that the filing of a petition for redetermination in the Tax Court "shall not operate to stay the execution of the order of the Board * * *" (Act of Feb. 25, 1944, ch. 63, § 701, 58 Stat. 87). Thus, from the inception of the redetermination provision under the first Renegotiation Act, the total separation of the redetermination and collection functions clearly reflected a Congressional intent to structure judicial redetermination utilizing a collect now, litigate later technique similar to techniques used under revenue statutes.[12]

The Renegotiation Act of 1951 (as first passed, 50 U.S.C. App. §§ 1211–1223 (1952)) was enacted during the Korean conflict and in most respects paralleled the World War II Act. However, the no-stay language of the first Act was replaced by the following provision:

> * * * The filing of a petition under this section shall operate to stay the execution of the order of the Board * * * if within ten days after the filing of the petition the petitioner files with the Tax Court a good and sufficient bond, approved by such court, in such amount as may be fixed by the court. 50 U.S.C. App. § 1218 (1952).

In explaining the addition of this bond provision, Representative Wilbur Mills of the House Ways and Means Committee stated on the floor of the House that the purpose of the bond language was to recognize in the statutory scheme existing informal practices followed by the Government under the first Renegotiation Act.[13]

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[12] The Supreme Court has upheld the constitutionality of the pay now, litigate later scheme of contesting unilateral revenue determinations similar to the scheme utilized in the instant case. Where an adequate opportunity is afforded for a later judicial determination of the legal rights, summary proceedings to secure prompt performance of pecuniary obligations to the government have been consistently sustained and found not to constitute a denial of due process. *Phillips* v. *Commissioner,* 283 U.S. 589, 595 (1931). *See also Bob Jones University* v. *Simon,* 416 U.S. 725 (1974) and *Alexander* v. *"Americans United" Inc.,* 416 U.S. 752 (1974).

50 U.S.C. App. § 1218 was subsequently amended by the Act of August 1, 1956, ch. 821, § 11(a), 70 Stat. 791, to read:

> * * * The filing of a petition under this section shall operate to stay the execution of the order of the Board * * * *only* if within ten days after the filing of the petition the petitioner files with the Tax Court a good and sufficient bond, approved by such court, in such amount as may be fixed by the court. (Emphasis added)

Both the House and Senate Reports specifically stated that the word "only" was inserted to clarify the original intention of Congress: that the filing of a good and sufficient bond is *required* to stay an order of the Renegotiation Board. H.R. REP. No. 2549, 84th Cong., 2d Sess. 9–10 (1956) and S. REP. No. 2624, 84th Cong., 2d Sess. 11 (1956).

The transfer of jurisdiction to this court in 1971 under Public Law 92–41 retained the substantive language of § 1218 after the 1956 amendment, and merely substituted the Court of Claims in place of the Tax Court as the redetermining court. This transfer of jurisdiction brought about one incidential change of possible significance. For the first time, both the collecting court and the redetermination court were one and the same. However, as we stated in *Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 111, 462 F. 2d 1388, 1390 (1972), "without any clear indication [from Congress] that the position of the parties respecting collection is altered, no change would be implied." In other words, the pay now, litigate later sequence has been carried over to judicial redetermination in this court.

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[13] The bond provision was added by amendment on the floor of the House of Representatives. In supporting this provision, Representative Wilbur Mills, a member of the House Ways and Means Committee, stated:

"I have discussed the gentleman's amendment with some of the members of the [Ways and Means] committee on this side and we see no objection to it. It may be that some changes will have to be made elsewhere in the bill, but the idea of the gentleman's amendment seems to be sound. I might call the gentleman's attention to the fact that, although it was not contained in the law during World War II, the filing of a bond with the Department of Justice would stay the execution of the order of the Board. There was an informal arrangement worked out to accomplish the same result so the gentleman's amendment is somewhat in keeping with that past practice. We have no objection to the amendment on this side." 97 CONG. REC. 605 (1951) (remarks of Representative Mills).

To summarize, Congress has consistently provided for immediate execution of an order of the Renegotiation Board separate and apart from judicial redetermination in such cases. The legislators finally did permit a stay of execution, but then only together with the timely filing of a bond.

Plaintiff, while not challenging the constitutionality of the pay now, litigate later technique employed by 50 U.S.C. App. § 1218, seems to take the position that the term "good and sufficient bond" when read in conjunction with "in such amount as may be fixed by the court" confers judicial discretion to set bond requirements on a case-by-case basis. In support of this premise, plaintiff places great reliance on the language of Ct. Cl. R. 26(e). However, plaintiff has misconstrued the court's intention in promulgating this rule and reads more discretion into § 1218 than we feel was intended by Congress.

In promulgating Ct. Cl. R. 26, this court followed the mandate of § 1218. In order to stay the execution of a Board order, plaintiff must file a bond within ten days after filing a petition. Ct. Cl. R. 26(a). A 100 percent surety[14] or collateral[15] bond has been fixed by the court as being "good and sufficient" to stay the execution of the Board's order. Ct. Cl. R. 26(b). In addition, the court added the following proviso:

> * * * Nothing contained in this rule [Ct. Cl. R. 26] shall preclude the entry at any time by the court (or the commissioner) of an order requiring that the amount of the bond be increased or decreased, upon a satisfactory showing that such increase or decrease is necessary. Ct. Cl. R. 26(e).

It is our view that the 100 percent bond requirement embodied in this rule adequately provides the protection Congress intended. After reviewing the legislative histories of the various Renegotiation Acts, there can be little doubt that

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[14] Ct. Cl. R. 26(c) defines sureties as follows: "Acceptable sureties on bonds shall be those bonding companies holding certificates of authority from the Secretary of the Treasury. (See the latest U.S. Treasury Dept. Circ. 570)."

[15] Ct. Cl. R. 26(d) limits acceptable collateral as follows: "If collateral is to be deposited as security for a bond, in lieu of a surety, United States Government marketable public securities, fully negotiable by the bearer, owned by the plaintiff, in a sum equal at their par value to the amount of the bond to be furnished, will be acceptable when accompanied by the necessary power of attorney."

Congress, in providing for the immediate execution of the Board's order, intended to insure the protection of the Government's interest against the dissipation of a plaintiff's assets during the pendency of the litigation. Surely no less protection was intended by permitting a stay of the execution and the prompt filing of a good and sufficient bond. We are convinced that Congress chose the words "in such amount as may be fixed by the court" to allow this court to decide if a 100 percent bond was sufficient to provide the same security as would the execution of a judgment. While this court could have set some higher percentage amount, we are persuaded that 100 percent is sufficient to comply with the Congressional mandate of § 1218 and have fixed this amount accordingly.[16]

Having fixed in our rules the required bond amount at 100 percent, we are of the opinion that Congress has prohibited us from even considering the proffer of a lesser percentage. This Congressional prohibition is the only logical interpretation of the ten day filing requirement imposed by § 1218. As we noted earlier, Congress amended § 1218 in 1956 to clarify the original intention of the bond provision. Only the prompt filing of the required bond would serve to stay the execution of the Board's order. By limiting the filing time, we think Congress implicitly precluded a case-by-case determination of what constitutes a "good and sufficient" bond. The very nature of plaintiff's original motion (to file a 70 percent bond) and opposition to defendant's motion for judgment in aid of execution would require this court to defer action beyond the ten day limit, particularly when the lesser bond is not even tendered until the final filing day. This is precisely the kind of situation which we believe Congress intended to avoid.[17]

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[16] It should be noted that the Tax Court, our predecessor as redetermining court, required the filing of a 112 percent bond as the minimum bond sufficient to stay the execution of the Board's order. *See* Tax Court Rule 65(b) (1958 revision).

[17] Our granting of plaintiff's request would have the effect of forcing this court to go into the bonding business. We would be compelled in each instance to review plaintiff's financial condition and ascertain valuation of various assets to determine if a plaintiff's tendered bond did, in fact, afford the Government with adequate protection against the threat of dissipation of said assets. It seems apparent that such an exercise would, by its very nature, extend considerably beyond the ten day period specified by Congress in 50 U.S.C. App. § 1218. This court lacks the investigatory facilities necessary for such a

(Continued)

Given the statutory constraints, we are of the opinion that plaintiff's suggested interpretation of CT. CL. R. 26(e) is misconceived. This rule was promulgated for a specific, limited purpose. Rather than authorizing this court to tailor the bond to an individual plaintiff at its original filing, CT. CL. R. 26(e) merely provides a mechanism for adjusting the *dollar* amount of an already filed bond where changed circumstances dictate such an alteration.[18] Such alteration of the dollar amount would be permitted only in those situations where one of the parties makes a showing that such adjustment is necessary to maintain the 100 percent equilibrium. To give this rule any other interpretation would have the effect of rendering the ten day filing time meaningless.

Since we deem it clear from the above discussion that plaintiff's tender of less than a 100 percent bond does not comply with our rule to stay the execution of the Board's orders, defendant's motion for judgment in aid of execution must be granted absent some unusual or mitigating circumstances that excuse plaintiff's failure. In the instant case, plaintiff has not succeeded in making such a showing.

This court has previously stated that a plaintiff seeking to avoid suffering execution of a judgment for failure to file the required bond must clearly show that the granting of the judgment might serve to "chill" the *de novo* redetermination litigation. *Sandnes' Sons, Inc.* v. *United States*, *supra.* The mere showing of financial hardship has been held to be insufficient to excuse noncompliance. *O'Brien Gear & Machine Co.* v. *United States*, 199 Ct. Cl. 1014 (1972).

Plaintiff has not shown any circumstances which would justify our denial of defendant's motion. In fact, plaintiff has

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(Continued)
prompt evaluation and would be forced to conduct a trial to determine sufficiency. During this entire reviewing period, the Government would be left totally unprotected, having neither a bond nor any judicial means for collecting the amount deemed owed by the Renegotiation Board. Moreover, case-by-case review would encourage the filing of frivolous appeals by plaintiffs seeking only to delay payment of Board orders. Such a result would clearly contradict the Congressional intention to utilize the pay now, litigate later sequence of § 1218.

[18] Such changed circumstances might include revision of a tendered 100 percent bond based on plaintiff's good faith estimate of Federal income tax credit when the actual figures became known. *See* note 1, *supra*. Additionally, other circumstances might necessitate an adjustment of the dollar amount, e.g., recalculation by the Board of the amount deemed excessive. However, it is clear that such revision occurs only after the initial filing of a 100 percent bond.

merely asserted that the bond tendered in the instant case might well provide defendant with better protection than the Government might obtain through seizure of plaintiff's assets under a judgment. Even assuming plaintiff's assertions to be correct, we feel constrained to point out that it is defendant's prerogative to decide for itself how it can best protect its interest. It is not the role of this court or plaintiff to make this executive determination.

We thus conclude that where a 100 percent bond is not timely filed, the Government possesses an immediate right to seek a judgment in aid of execution. Such judgment will be granted absent some compelling showing of unusual or mitigating circumstances. It is defendant's responsibility to use the judgment wisely. If defendant ascertains that the Government is in little danger of dissipation of plaintiff's assets, then it should negotiate a payment plan or other alternative with plaintiff so that plaintiff's business is not unnecessarily disrupted. But we as a court must presume that the Government will act in good faith and in the public interest. Plaintiff has not made any showing which rebuts this presumption.

Accordingly, defendant's motion for judgment in aid of execution of the Board's order is granted and judgment is entered in the amount of two hundred thirteen thousand nine hundred eighty-four dollars and twenty-nine cents ($213,984.29), with interest as provided by law. 50 U.S.C. App. § 1215(b)(2).

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NICHOLS, *Judge*, concurring:

I concur in the opinion and judgment but would like to add the following observations.

We have in the above case and in *Bannercraft Clothing Co., Inc.*, *post* at 199, two more of what bids fair to be an endless series of impecunious defense contractors seeking relief from excessive profits determinations. We naturally think of one who has allegedly realized excessive profits as being richer than we would deem proper. Why is he so often at the other end of the economic scale? If we can explain this apparent paradox, a more satisfactory disposition of the cases may be possible.

At times the condition results from an uneven distribution of profit and loss contracts over different fiscal years, with insufficient impact of carry forward and other equalization measures. See my article, *Equalizing Profit and Loss In Renegotiation*, 45 Va. Law Rev. 41 (1959). Other times, those in control of corporations or partnerships have taken advantage of the usual long lapse of time between the end of a fiscal year and a Board order dealing with that year, to drain off the profits to transferees. Despite mistaken assertions to the contrary, dissenting in *Sandnes' Sons, Co.* v. *United States*, 199 Ct. Cl. 107, 120, 462 F. 2d 1388, 1395 (1972), it is also perfectly possible for a person who never does business with the United States, never has a contract or purchase order containing a renegotiation clause or notice, and never heard of the Renegotiation Act to become subject to renegotiation. Such person may pay off profits to stockholders or creditors without setting up a proper reserve for this liability, and learn of it only later. Thus we are dealing with some people who have got into this predicament without any fault or negligence of their own, and with others whose good faith we may well decry. But even this latter group may ask where is the provision in the Renegotiation Act to bar their distributing assets to transferees while a renegotiation is pending? None can be found.

I hasten to add, I have no idea in which category the parties now before us belong.

The collection provisions of the Renegotiation Act of 1951, 50 U.S.C. App. § 1215(b) (1) and ff. were originally drafted for the 1943 Act, in the midst of World War II. At that time no one could do business in many industrial lines of endeavor, unless he did renegotiable business. It appeared reasonable to look to the withholding of payments on future defense contracts or subcontracts as the primary means of enforcing liability to refund excessive profits on prior contracts or subcontracts, pursuant to agreement or order. In any event, the impact of wartime excess profits taxes made it necessary to collect only about 20% of refund determinations made. As a backup method of collection only, suit was provided for in § 1215(b) (3). There was and is no provision for jeopardy assessment or transferee liability. To the contrary, assignee banks and Miller Act sureties are protected and are not required to assist in refund collection in any way. § 1215(b) (4) and (5).

I well remember responsible officials of the then renegotiating agencies predicting that if renegotiation continued in effect after V–J day, collection would become an insuperable problem. Yet it has never been squarely confronted and appropriate collection measures have never been devised for the new situation.

The instant case involves FY's 1967, 68 and 69, and *Bannercraft* 1966 and 67. Thus we have renegotiation proceedings dragging along year after year, with nothing done to exact security for payment, and nothing that can be done. Maybe, many times, the horse has long since been stolen when the barn door is locked, *i.e.*, when the order enters and the petition is filed here. If they want to stay collection, they then must file their bonds. Bonds are hard for the impecunious to come by in these times, if they were ever easy, except for those so prosperous as to need no bonding.

If they don't file the required bonds within ten days, we must enter judgment on the Government's counterclaim. Such, we held in *Sandnes'* and again today, is the intent of Congress. In *Sandnes'* we deferred the judgment pending inquiry whether the plaintiff's right to due process was unconstitutionally chilled, but even this mild temporizing was vehemently protested by three dissenters. In any case, that plaintiff never made the required showing and ultimately the judgment was entered as demanded.

In my view, 99% of the time the judgment on the counterclaim will either be needlessly harsh on one who has got into difficulty by no fault of his own, or else will be too late to prevent diversion of funds the Government had a right to expect—at least, a moral right—would be held as a reserve to satisfy the renegotiation liability when determined. The procedure in my view, has no relation to a rational program to secure the Government against diversion of excessive profits into unreachable pockets.

Some times it may be appropriate to strain the interpretation of a statute to make it conform to reality. I do not think this is such a case. Any effort of ours along such a line would, I think, only make matters worse. In case of doubt, it is not a bad idea to find out what the intent of Congress is, and to do just that.

I don't think it is improper for us, however, to note the existence of a problem Congress has perhaps not solved, and to recommend a study of it by an executive or legislative agency having the authority and facilities to do so, with a view to possible new legislation. In such an investigation our case files would be prime sources of relevant data.

DAVIS, *Judge*, dissenting:

Although it is clear that Congress wished to protect the United States during court redetermination of a finding of excessive profits by the Renegotiation Board, there is absolutely nothing in the text of the Act or the legislative history to compel the requirement of a 100% bond or to forbid a bond in a lesser sum if it is deemed to be "good and sufficient." I read our Rule 26 in the same way. Paragraph (b) provides that, normally and in ordinary course, a 100% bond is to be filed, but paragraph (e) says: "*Nothing contained in this rule* shall preclude the entry *at any time* by the court (or the commissioner [trial judge]) of an order requiring that the amount of the bond be increased or decreased, upon a satisfactory showing that such increase or decrease is necessary" [emphasis added]. This all-embracing language encompasses the possibility of a less-than-100%-bond, from the beginning, if such a smaller obligation is determined to be "good and sufficient" in the particular circumstances.

This plaintiff, within the ten-day period, proffered a 70% bond, asserting that (a) it was unable to obtain a bond in the higher amount, and (b) that the tendered bond provided the Government with better protection than could be obtained through seizure of the dissolved corporation's assets under a judgment of the kind the court now grants. In the present posture of the case, these allegations must be accepted. If true, they seem to me to satisfy all the requirements of both the statute and Rule 26. I would therefore remand the case to the trial division to determine the accuracy of the company's assertions.*

The court suggests that this procedure would force the court "to go into the bonding business." I do not agree because I do not think that most, or even many, of the class of renegotiated contractors can make *under oath* the allegations made here—that a 100% bond is unobtainable and that better protection will be afforded the Government by the proffered bond than by execution under judgment for the amount of the renegotiation orders. To allow this contractor the opportunity to prove its case does not mean that we have to do the same for others who cannot make the same assertions under penalty of perjury.

On the other hand, the consequence of the court's ruling is that this contractor is put at the Government's mercy—the Government can execute at will on the corporate property—even though, so far as we know now, the defendant does not need in this case such unlimited and potentially destructive power in order to be protected against loss. As between some inconvenience to the court and potential injury of this stripe to a contractor, I would choose the former. Indeed, the burden of litigation is likely to be less than we now have from contractors contesting the Government's motions for judgment in aid of execution of the renegotiation orders (where no bond or less than a 100% bond is filed).

518 F. 2d 605

# BANNERCRAFT CLOTHING COMPANY, INC. v. THE UNITED STATES

[Nos. 354-74 & 355-74. Decided June 25, 1975]

ON DEFENDANT'S MOTIONS FOR JUDGMENTS IN AID OF EXECUTION OF THE RENEGOTIATION ORDERS OF JULY 1, 1974

**Renegotiation of contracts; redetermination of excessive profits; sufficiency of bond to stay execution of order of Renegotiation**

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*During the time the trial division takes to determine this issue, the Government would be protected by the 70% bond. If no bond at all is filed and the contractor litigates, as the court acknowledges he can, the defendant's motion for judgment in aid of execution of the renegotiation orders, there is no protection at all for the Government during the period of consideration and determination of that motion.

**Board; Court of Claims jurisdiction.**—On September 26, 1974 plaintiff petitioned this court seeking redetermination of the amount of excessive profits found by the Renegotiation Board. On November 21, 1974 defendant replied and counterclaimed to each of the petitions, as well as moving for judgment in aid of execution of the Board's orders, plaintiff having failed to file timely the bond required by Rule 26. On February 6, 1975 plaintiff requested the court's approval of the furnishing of a Covenant Not to Convey certain real estate and various other guarantees as collateral sufficient to stay execution, contending that the tendered security on otherwise unencumbered land should be considered "good and sufficient bond" under 50 U.S.C. App. § 1218, and that this court does not have jurisdiction to enter judgment on defendant's motions. In *Manufacturers Service Co.* v. *United States*, decided today, *ante* at 185, the court examined the legislative history of the bond provision of Sec. 1218, *as amended*, and concluded that Congress, by consistently providing for immediate execution of an order of the Renegotiation Board separate and apart from judicial redetermination, intended to insure the protection of the Government's interest against the dissipation of a contractor's assets during pendency of the litigation. It is *held* that plaintiff's tender of an interest in real estate as collateral fails to satisfy the requirements of Rule 26; that even if the tendered collateral were of the type approved by this court, its tardy filing precludes the granting of a stay of execution of the Board's orders absent a showing of some unusual or mitigating circumstances excusing plaintiff's failure; and that this court has jurisdiction to grant defendant's motions for judgment under 28 U.S.C. § 2508 in renegotiation cases, even though the claim in chief is undecided. Defendant's motions for judgment in aid of execution of the Board's orders are granted, and judgment is entered for $777,929.35, with interest as provided by law.

**Renegotiation of contracts; pleading and practice; bond to stay execution of order of Renegotiation Board.**

[1] Rule 26 of this court providing for the filing of a bond to stay execution of an order of the Renegotiation Board determining the amount of excessive profits realized by a contractor was promulgated to implement the consistent congressional intent since enactment of Sec. 108 of the Renegotiation Act of 1951 to insure the protection of the Government's interest against the dissipation of a contractor's assets during pendency of judicial redetermination by providing for immediate execution of the order separate and apart from such redetermination.

**War and National Defense 🔑 59**

**Renegotiation of contracts; pleading and practice; bond to stay execution of order of Renegotiation Board.**

[2] A Contractor's tender of an interest in real estate to stay execution of an order of the Renegotiation Board is unacceptable collateral

since such interest offers neither of the advantages of the bonds acceptable under this court's Rule 26 (c) and (d), would require valuation by the court to determine whether the proffered collateral possesses a current dollar worth equal to at least 100% of the Board's order, and would frustrate the congressional intent to utilize the pay now, litigate later sequence of 50 U.S.C. App. § 1218.

War and National Defense 🔑 59

**Renegotiation of contracts; redetermination of excessive profits; judgment in aid of execution of order of Renegotiation Board; indigent litigants.**

[3] Absent the furnishing of a bond complying with Rule 26, the mere assertion by a contractor of potential financial hardship is insufficient to prevent the entry of a judgment in aid of execution of an order of the Renegotiation Board determining the amount of excessive profits realized by the contractor.

War and National Defense 🔑 59

**Renegotiation of contracts; pleading and practice; counterclaim for uncollected amount of excessive profits.**

[4] In litigation seeking redetermination of the amount of excessive profits realized by a contractor found by the Renegotiation Board, where an approved surety or collateral bond is not timely filed pursuant to Rule 26, the Government possesses an immediate right to seek a judgment in aid of execution of the order. This court has jurisdiction to grant such a judgment under 28 U.S.C. § 2508 in renegotiation cases, even though the claim in chief is undecided.

War and National Defense 🔑 59

*Robert L. Ackerly*, for plaintiff; *Gilbert A. Cuneo*, attorney of record. *James J. Gallagher*, *Sellers, Conner & Cuneo*, of counsel.

*Sheldon J. Wolfe*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

The question here at issue is whether a Covenant Not to Convey (or other interest in real estate) is acceptable collateral sufficient to stay the execution of the orders of the

Renegotiation Board (Board) during *de novo* redetermination in this court. A similar issue was presented in *Manufacturers Service Co.* v. *United State*, *ante* at 185, 518 F. 2d 1202 (1975). We reaffirm the principle enunciated in *Manufacturers Service Co.* v. *United States*, *supra*, and hold that execution of the Board's orders is stayed only by the filing of a 100 percent surety or collateral bond as defined by CT. CL. R. 26.

Plaintiff corporation filed its petitions in this court on September 26, 1974 for a redetermination of excessive profits for its fiscal years 1966 and 1967, under Section 108 of the Renegotiation Act of 1951, 50 U.S.C. App. § 1218, *as amended* (Supp. II, 1972). Its renegotiable sales, according to the petitions, were $7,350,766.74 [1] and its renegotiable profits were $1,825,981.15,[2] of which the Board determined that $1,496,018 was excessive.[3] Federal tax credits for the two years at issue were determined by the Internal Revenue Service to be $718,088.65,[4] leaving the Board's determinations of net excessive profits [5] at $777,929.35.[6]

On November 21, 1974, defendant filed its answer and counterclaim to each of plaintiff's two petitions. At the same time, defendant filed the present motions for judgment in aid of execution of the Board's orders. As of the above date, plaintiff had made no attempt to file any bond with this court nor had any attempt been made to obtain a judicial waiver of the bond requirement.[7] Instead, plaintiff waited until February 6, 1975, the date of its response to defendant's motions for judgment, to request this court's approval of a Covenant Not to Convey and various other guarantees as collateral sufficient to stay the execution of the Board's orders. Plaintiff added a jurisdictional argument by supplemental brief filed March 17, 1975.

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[1] Renegotiable sales for the two years were as follows:

FY 1966—$2,349,882.50
FY 1967—$5,000,884.24

[2] Renegotiable profit for each component year was as follows:

FY 1966—$ 187,530.94
FY 1967—$1,638,450.21

[3] Annual excessive profits, adjusted for taxes measured by income, other than Federal taxes, were as follows:

FY 1966—$ 64,921.00
FY 1967—$1,431,097.00

[4] Federal tax credit for each component year as determined by the Internal Revenue Service was as follows:

FY 1966—$ 31,162.09
FY 1967—$686,926.56

[5] Net excessive profits are the excessive profits found by the Renegotiation Board less appropriate tax credits. Before issuing an order, the Board adjusts the excessive profit computation to reflect allowable credit for any taxes measured by income, exclusive of Federal income taxes. A further credit for Federal income taxes is computed by the Internal Revenue Service subsequent to the Board's order. In computing the amount of the bond to be filed in order to stay the execution of the Board's order, our court rules require 100 percent of the net amount owed. Where the Internal Revenue Service has not yet determined the exact amount of the Federal tax credit, this court will accept plaintiff's good faith estimate of the offset, subject to modification when the actual figures are known.

[6] Net excessive profits found by the Renegotiation Board adjusted for Federal tax credit for each component year were as follows:

FY 1966—$ 33,758.91
FY 1967—$744,170.44

Plaintiff's opposition to defendant's motions is two-fold. It is plaintiff's primary position that contra to our Rule 26 definition, the tendered security on otherwise unencumbered land should be considered "good and sufficient bond" under 50 U.S.C. App. § 1218. Plaintiff additionally submits that this court does not have jurisdiction to enter judgment on defendant's motions.

Defendant argues that acceptance of plaintiff's tendered security would undercut the Congressional intent of providing prompt protection of the Government's interest during the pendency of litigation. Defendant further asserts CT. CL. R. 26 is dispositive as to what is a "good and sufficient" bond. Such determination should not be disturbed except by the promulgation of a different rule applicable to all plaintiffs. For the reasons stated below, we hold for defendant.

In *Manufacturers Service Co., Inc.* v. *United States*, *supra*, this court examined the legislative history of the bond provision contained in Section 108 of the Renegotiation Act of 1951, 50 U.S.C. App. § 1218, *as amended* (Supp. II, 1972). We concluded that Congress, by consistently providing for immediate execution of an order of the Renegotiation Board separate and apart from judicial redetermination, intended to insure the protection of the Government's interest against the dissipation of a plaintiff's assets during the pendency of the litigation. Such protection would, of course, be afforded if a plaintiff paid the amount of the Board's order and then brought suit in this court for a refund claim. Alternatively, the Government's interest would be protected by an award of a judgment in the same amount. In lieu of a judgment, however, it was deemed by Congress that the prompt filing of a good and sufficient bond, affording essentially the same protection as the above two methods, would be permitted to stay the execution of the Board's order.

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[7] Plaintiff asserts that it did not file a motion requesting this court to accept real estate collateral in lieu of bond because counsel for plaintiff and defendant were discussing a possible consent by the defendant to a bond secured by plaintiff's interest in the real property. Plaintiff submits it raised the issue before the court only after defendant filed its Motions for Judgment. Nevertheless, it is conceded that plaintiff did not comply with our Rule 26.

Ct. Cl. R. 26 was promulgated to implement the above Congressional intention vis-a-vis the acceptance of a bond to stay the execution of the Board's order. Such stay would only be permitted in the limited circumstances where, within ten days after the filing of a petition, plaintiff tenders a 100 percent surety or acceptable collateral bond. *Manufacturers Service Co.* v. *United States*, *ante* at 185, 518 F. 2d at 1206.

Plaintiff's tender of an interest in real estate as collateral, even if timely filed, fails to satisfy Ct. Cl. R. 26. Ct. Cl. R. 26(c) defines acceptable sureties as follows:

> * * * Acceptable sureties on bonds shall be those bonding companies holding certificates of authority from the Secretary of the Treasury. (See the latest U.S. Treasury Dept. Circ. 570).

Ct. Cl. R. 26(d) limits acceptable collateral as follows:

> * * * If collateral is to be deposited as security for a bond, in lieu of a surety, United States Government marketable public securities, fully negotiable by the bearer, owned by the plaintiff, in a sum equal at their par value to the amount of the bond to be furnished, will be acceptable when accompanied by the necessary power of attorney.

By approving the above two types of bonds, this court has provided a well-defined means by which a stay can be obtained. The filing of either type of bond with the clerk of this court can be accepted without requiring a court-conducted investigation of sufficiency. Since no inquiry is necessitated, both the filing and acceptance of either bond can be accomplished within the ten day grace period of both 50 U.S.C. App. § 1218 and Ct. Cl. R. 26(b). In addition, both the surety and collateral bonds approved by the court possess the added advantages of stability and liquidity. The dollar guarantees of each are immune from market fluctuations which could adversely affect the value of other forms of collateral.

By contrast, plaintiff's interest in real estate as collateral offers neither of the advantages of the bonds acceptable under CT. CL. R. 26. Rather than being automatically acceptable, an interest in real estate would require valuation by the court to determine whether the proffered collateral possesses a current dollar worth equal to at least 100 percent of the Board's order. Such valuation by its very nature would necessarily extend well beyond ten days after the filing of plaintiff's petition. During this entire valuation period, the Government would be left totally unprotected, having neither a bond nor any judicial means for collecting the amount deemed owed by the Board. Such a result would clearly frustrate the Congressional intention to utilize the pay now, litigate later sequence of 50 U.S.C. App. § 1218.

Likewise, an interest in real estate does not offer the same dollar protection of the two court approved bonds. Unlike Government marketable securities or the guarantee of certified bonding companies, the appraised value of land does not insure that such amount would be realized if the land were sold. Indeed, even plaintiff recognizes this instability by asking this court to accept the fact that land subject to a forced sale might not realize a sales price even close to its appraised value or to that which could be negotiated between a willing seller and a willing buyer. It is precisely this above possibility which led this court to conclude that real estate collateral is not an acceptable type of bond.

In the instant case, plaintiff has not even attempted to comply with the filing time requirement of CT. CL. R. 26(b). The ten-day period for seeking a stay is an integral part of the bond provision of 50 U.S.C. App. § 1218. Without such a time limitation, it seems apparent that the Congressional intention of prompt payment to protect the Government's interest could be circumvented by the filing of frivolous appeals by plaintiffs seeking only to forestall compliance. Thus, even if the tendered collateral was of the type approved by this court, its tardy filing would preclude the granting of a stay of execution of the Board's orders.

Since plaintiff's belated tender of an interest in real estate as collateral does not comply with our rule to stay the execution of the Board's orders, defendant's motions for judgment must be granted absent some unusual or mitigating circumstances that excuse plaintiff's failure. In the instant case, plaintiff has not succeeded in making such a showing.

The thrust of plaintiff's opposition to defendant's motions is centered on the alleged financial hardship plaintiff would suffer if judgment was entered. However, the mere assertion of potential financial hardship has been held to be insufficient to prevent the entry of a judgment in aid of execution. *Manufacturers Service Co., Inc.* v. *United States*, *supra*, and *O'Brien Gear & Machine Co.* v. *United States*, 199 Ct. Cl. 1014 (1972). In the instant case, plaintiff has presented nothing that would persuade this court to apply a different standard.

As to plaintiff's jurisdictional challenge, we are of the belief that our holding in *Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 462 F. 2d 1388 (1972), is dispositive. Plaintiff argues that defendant's motion for judgment in aid of execution is, in effect, a counterclaim, by whatever name it is called. As such, our statutory authority for granting judgment on a counterclaim, 28 U.S.C. § 2508, precludes our rendering of the requested judgment while plaintiff's claim in chief is undecided. In other words, plaintiff asserts the Government does not presently have any claim for money damages and will only obtain a claim if the defendant prevails in the principal action. This is the exact argument we rejected in *Sandnes' Sons, Inc.* v. *United States*, *supra*, and we again reject today.[8]

We thus conclude that where an approved surety or collateral bond is not timely filed, the Government possesses an immediate right to seek a judgment in aid of execution. This court has jurisdiction to grant defendant's motions for judgments under 28 U.S.C. § 2508 in renegotiation cases, even though the claim in chief is undecided. Such judgment will be granted absent some compelling showing of unusual or mitigating circumstances.

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[8] If we were to accept plaintiff's position, the Government would be required to seek collection of the Renegotiation Board's order in a Federal District Court just as if plaintiff had chosen not to appeal the Board's order. In a Federal District Court collection action, the Government would be a plaintiff and thus avoid the counterclaim question. Since the outcome of the District Court action would almost certainly be the same as we would decide, the only gain plaintiff could possibly achieve would be to forestall payment. Such delay would clearly frustrate the Congressional intention of prompt protection against the potential dissipation of a plaintiff's assets during the pendency of litigation.

Accordingly, defendant's motions for judgment in aid of execution of the Board's orders are granted and judgment is entered in the amount of seven hundred seventy-seven thousand nine hundred twenty-nine dollars and thirty-five cents ($777,929.35), with interest as provided by law. 50 U.S.C. App. § 1215(b)(2).

DAVIS, *Judge*, concurring in the result:

This company did not attempt to file any sort of bond within the ten-day period (or a reasonable time thereafter), nor has it ever offered a monetary bond. In this respect the case seems to me to differ significantly from *Manufacturers Service Co.* v. *United States*, *supra*. The Renegotiation Act and our Rule 26 contemplate a monetary bond, not real-property collateral. Perhaps if plaintiff had tendered a timely temporary bond and then later sought to substitute the real-estate collateral, there could be room for the court, in its discretion, to accept the substitution. But plaintiff did not take that route and I agree that its only proffer fails to comply with the statute and the rule. On the jurisdictional issue I join the court.

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518 F. 2d 1369

## LEROY W. ABELL, ET AL. v. THE UNITED STATES

No. 261–72

## JACK R. BARGER, ET AL. v. THE UNITED STATES

No. 371–73

[Decided June 25, 1975. Plaintiffs' motions for rehearing, for suggestion for rehearing *en banc*, and for other relief denied January 9, 1976.]

ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; Sunday premium pay; wage board employees; Bonneville Project.**—Plaintiffs, wage board employees of the Bonneville

Power Administration, Interior Department, allege that they are being denied the 25% Sunday premium pay required by Sec. 405(f) of the Federal Employees Salary Act, enacted July 18, 1966; alternatively, that if that provision is not applicable they are entitled to the said premium pay because "the prevailing rates in the industry provide for premium pay for Sunday work" and Bonneville is required to fix compensation for plaintiffs in accordance with the prevailing rates in the public electrical utilities industry in the Pacific Northwest. Bonneville's hourly employees are appointed in accordance with the Civil Service laws but their compensation differs from annual employees, and since 1945 their compensation has been determined, pursuant to an amendment to Sec. 10(b) of the Bonneville Project Act, by yearly collective bargaining and fixed without regard to any other law, rule or regulation. The past and present collective bargaining agreements fixing wages do not provide for Sunday premium pay for these employees. Plaintiffs have been paid only on the basis of a 40-hour week at hourly rates of pay. Since July 18, 1966 the normal schedule of those plaintiffs who work rotating shifts in positions which are manned around the clock, 7 days per week, requires that each work approximately 39 Sundays per year, and the schedule of those plaintiffs who occupy positions at 24-hour call stations requires that each work approximately 26 Sundays per year. After a review of the legislative, executive and agency materials relating to the establishment, continuing operations and employees' compensation of Bonneville, as well as, *inter alia*, the Classification Act of 1949 and the Federal Employees Salary Act of 1966, it is *held* (1) that there is no inconsistency between the authority given to Bonneville in 1945 and Sec. 202(7) of the Classification Act of 1949; (2) that Sec. 10(b) was not repealed by the 1949 Act; (3) that the result in plaintiffs' wages may be fixed without regard to the 1966 Act; (4) that as the 1949 Classification Act was only a substitute for the earlier act and did not specifically repeal the 1945 special legislation amending the Bonneville Project Act, Bonneville's employees are excepted from that act by Sec. 10(b); and (5) that since plaintiffs did not file any counter affidavit answering the affidavit presented by defendant demonstrating that the pertinent utilities industry does not pay premium wages for regularly scheduled Sunday work, the alternative claim must be denied. Defendant's motion for summary judgment is granted, plaintiffs' motion for summary judgment is denied, plaintiffs' amended complaint in No. 261–72 and the complaint in No. 371–73 are dismissed, and defendant's contingent counterclaim in both actions is also dismissed.

Civilian pay; premium pay; Sunday premium pay; wage board employees; Bonneville Project.

[1] Under Sec. 10(b) of the Bonneville Project Act, as amended by Pub. L. 201 dated October 23, 1945, the administrator of the Bonneville Power Administration may fix the compensation of its laborers, mechanics and workmen without regard to any other

laws, rules or regulations relating to the payment of employees of the United States, and the subsequent enactment of Sec. 405(f) of the Federal Salary and Fringe Benefits Act providing 25% Sunday premium pay for employees of the United States is inapplicable to Bonneville's laborers, mechanics and workmen.

United States 🔑 39(4)

**Statutes; construction and operation; code and statute, conflict between.**

[2] Where there is a conflict between the codification and the Statutes at Large, the latter must prevail even where there is codification into positive law. Thus, the fact that 16 U.S.C. § 832i(b) as it is now codified eliminated the provision of Sec. 10(b) of the Bonneville Project Act authorizing the Administrator to fix the compensation of laborers, mechanics and workmen without regard to the Classification Act of 1949 and any other laws, rules or regulations relating to the payment of employees of the United States, is not controlling on the issue of whether wage board employees of Bonneville Power Administration are entitled to 25% Sunday premium pay pursuant to Pub. L. 89–504 (5 U.S.C. § 5544 (a)).

Statutes 🔑 147

**Statutes; construction and operation; repeal by implication.**

[3] As a general rule, repeal of a statute by implication is not favored. A new statute will not be read as wholly or even partially amending a prior one unless there exists a positive repugnancy between the provisions of the new and those of the old that cannot be reconciled.

Statutes 🔑 158

**Statutes; construction and operation; general and special or specific legislation.**

[4] Special statutes will prevail over general statutes without regard to the priority of enactment. Thus, where the legislative history of the 1945 amendments to the Bonneville Project Act demonstrates that Bonneville was given special authority in matters of wage board employees' pay not subject to the 1923 Classification Act, and since the 1949 Classification Act was only a substitute for the earlier act and did not specifically repeal the 1945 special legislation amending the Bonneville Project Act, Bonneville's employees are still excepted from the Classification Act by Sec. 10(b) of the Bonneville Project Act.

United States 🔑 39(4)

**Civilian pay; Court of Claims jurisdiction; Civil Service Commission decision; review of by court; Classification Act of 1949.**

[5] A determination of the Civil Service Commission that Sec. 10 (b) of the Bonneville Project Act as amended by Sec. 5b of the Act of October 23, 1945 was superseded by implication by the Classification Act of 1949 is reviewable by this court where in the court's

view there has been a misconstruction of the governing legislation, despite the finality provision of Sec. 203 of the Classification Act.

United States ⚿ 39(11)

**Statutes; construction and operation; legislative intent; subsequent Congress, opinion expressed by.**

[6] The expression of opinion as to the meaning of a statute, made several years after the enactment of the statute, by the same congressional committee which had considered that statute at the time of its enactment, is an important circumstance for consideration in interpreting it. (*Sioux Tribe of Indians* v. *United States*, 316 U.S. 317, 329 (1942)). In the instant case, the court considers it an important circumstance that the report of the Committee of the Congress following the one which passed the Classification Act of 1949 did not consider Sec. 10(b) of the Bonneville Act repealed by the Classification Act of 1949 but as still in force; and the approval of the report by the Committee made up of 10 Senators (out of 13) of the previous Congress is material and must not be taken lightly.

Statutes ⚿ 217.4

**Statutes; construction and operation; repeal by implication.**

[7] In deciding whether a statute has been repealed by implication, the court may consider the consequences of such repeal. Thus, this court is averse to an implied repeal by the Classification Act of 1949 of Sec. 10(b) of the Bonneville Project Act where such action would affect a basic subsequently enacted financing statute authorizing issuance of bonds up to $1.25 billion by Bonneville and which assumes by specific reference that the powers granted in Sec. 10(b) still exist.

United States ⚿ 39(4)

*David Minton* for plaintiff; *Robert A. Saltzstein*, attorney of record. *Wyatt, Saltzstein, Minton and Howard; Paul G. Olsen, Jones, Olsen & Christensen;* and *Arnold Olsen*, of counsel.

*Francis H. Clabaugh*, with whom was *Assistant Attorney General Carla A. Hills*, for defendant. *Lawrence Cox*, of counsel.

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Before DAVIS, SKELTON, and KASHIWA, *Judges*.

KASHIWA, *Judge*, delivered the opinion of the court:

Plaintiffs, wage board employees of the Bonneville Power Administration of the Department of the Interior (hereinafter Bonneville), claim in this suit that they are being denied 25 per cent Sunday premium pay required by Section

405(f) of the Federal Employees Salary Act of 1966 (5 U.S.C. § 5544(a)) and alternatively that if they are not entitled to 25 per cent Sunday premium pay under this act, they are nonetheless entitled to it because "the prevailing rates in the industry provide for premium pay for Sunday work" and Bonneville is required to fix compensation for plaintiffs in accordance with the prevailing rates in the public electrical utilities industry in the Pacific Northwest.

This is a consolidation of the cases of *Barger*, *et al.* v. *United States*, Ct. Cl. No. 371–73, and *Abell*, *et al.* v. *United States*, Ct. Cl. No. 261–72. There is no genuine issue as to any material fact. Essential facts have been stipulated. Parties have filed cross motions for summary judgment. We hold for the defendant in both cases, allowing defendant's motion for summary judgment and denying plaintiffs' motion for summary judgment.

The stipulated facts are as follows. Bonneville was started and established under the Act of August 20, 1937 (50 Stat. 731, as amended, 16 U.S.C. §§ 832–832l (1970)), within the Department of the Interior. It is required and charged by statute, Executive order, and orders of the Secretary of the Interior with responsibility for marketing electric power generated from Federal hydroelectric projects in the Pacific Northwest (Bonneville Project Act, Act of August 20, 1937, 50 Stat. 731, as amended, 16 U.S.C. §§ 832–832l (1970); § 2 River and Harbor Act of 1945, Act of March 2, 1945, 59 Stat. 10, 22; § 5 Flood Control Act of 1944, Act of December 22, 1944, 58 Stat. 887, 890; Executive Order No. 8526, 5 Fed. Reg. 3390 (1940); Secretarial Order No. 2860, as amended, 27 Fed. Reg. 591 (1962), 28 Fed. Reg. 5273 (1963), 31 Fed. Reg. 13560 (1966)). To fulfill these responsibilities, Bonneville has constructed, operates and maintains a major electrical transmission system which exceeds 12,000 miles. It has also constructed appropriate load dispatching centers and substations throughout the states of Oregon, Washington, Idaho and Montana, the geographic area of its system. The transmission lines and related electric facilities represent an investment of more than $1.2 billion. Investment in electrical generation facilities for which Bonneville has the repayment obligation is an additional $1.9 billion. Total system revenues for 1973 exceeded $177.4 million.

Bonneville employs about 3,828 employees, 1,400 of whom are hourly employees whose compensation is fixed through collective bargaining, to operate and maintain this vast system which includes more than 200 load dispatching centers or substations, 50 of which are manned by dispatchers, operators and relief operators seven days a week throughout the year. Over one-half of these are manned continuously, 24 hours a day. These dispatchers, operators and relief operators are hourly employees whose rates of compensation are fixed through contract negotiation between Bonneville and the Columbia Power Trades Council (hereinafter the union), a council composed of 16 unions including the International Brotherhood of Electrical Workers.

Bonneville's hourly employees are appointed in accordance with the Civil Service laws of the United States and for purposes of retirement, sick leave, annual leave, severance pay, workmen's compensation and other benefits are treated substantially the same as annual employees. Only in the significant area of compensation do these employees differ markedly. Since 1945 their compensation has been arrived at by collective bargaining and fixed without regard to any other law, rule or regulation of the United States. The initial authority for Bonneville to undertake collective bargaining and to fix the compensation of its hourly employees in this fashion is contained in the 1945 amendments to the Bonneville Project Act (Act of October 23, 1945, 59 Stat. 546, 547), and defendant claims that the authority has remained unchanged.

Between 1937 and 1945 the laborers, mechanics and workmen employed by Bonneville were true wage board employees. They were excluded from coverage of the 1923 Classification Act. Their rates of pay were fixed by administrative action. After 1945, pursuant to the above-referenced amendments, their compensation was fixed through collective bargaining. To develop a base for negotiations, Bonneville surveyed utilities within the Pacific Northwest employing similar crafts. At some time subsequent to 1945, Bonneville and the union representing Bonneville's hourly employees adopted the practice of making a joint survey. Representatives of Bonneville and the union cooperate in preparing this survey. Originally, only six utilities were surveyed; however, when the joint survey was expanded to include the United States Bureau of Reclamation and the Corps of Engineers, the number of utilities was increased to eight. These include the four largest private electric utilities in the Pacific Northwest—Pacific Power & Light Company, Portland General Electric Company, Puget Sound Power & Light Company and the Washington Water Power Company; two large public utility districts (hereinafter PUD) which have significant electrical generation—Grant County PUD and Chelan County PUD; and the two largest municipally owned electric utilities—Seattle City Light and Tacoma City Light.

The Bureau of Reclamation uses this survey to negotiate wage rates for employees employed at Grand Coulee, Washington; and the Corps of Engineers submits this survey data to a wage-fixing authority in Washington, D.C., which establishes wage rates for the Northwest.

The current collective bargaining agreement between the union, which is the exclusive representative for the class which includes all plaintiffs, does not provide for Sunday premium pay for Bonneville's hourly employees. Agreements have been negotiated each year since the enactment of Section 405(f) of the Federal Salary and Fringe Benefits Act of 1966 (80 Stat. 288) (now codified as 5 U.S.C. § 5544(a) (1966)), establishing the Sunday premium. The benefit which plaintiffs claim has never been included in any negotiated agreement. It was specifically requested by the union during the 1967 annual contract negotiations between Bonneville and the union and rejected by Bonneville on the ground that the current wage survey indicated it was not a prevailing rate. Since that date the union has not requested this Sunday premium pay in its annual negotiations.

During all of the period of employment set forth in plaintiffs' petition, plaintiffs were paid on the basis of a 40-hour week at hourly rates of pay. None of the plaintiffs received any premium compensation for Sunday work as that term is used in the Federal Salary and Fringe Benefits Act of 1966, enacted July 18, 1966.

The normal schedule of those plaintiffs who work rotating shifts in positions which are manned around the clock, seven days per week, requires that each work approximately 39 Sundays per year from July 18, 1966.

The normal schedule for those plaintiffs who occupy positions at 24-hour call stations requires that each work approximately 26 Sundays per year from July 18, 1966.

Plaintiffs originally filed their petition alleging that Public Law 89-504, 5 U.S.C. § 5544(a) (1966), required payment to them by Bonneville of 25 per cent premium pay for Sunday work. By amendment dated December 6, 1972, plaintiffs further allege that if 5 U.S.C. § 5544(a) is not applicable to them, they are nonetheless entitled to 25 per cent Sunday premium pay "because the prevailing rates in the industry provide for premium pay for Sunday work" and Bonneville is required to fix the compensation for plaintiffs in accordance with the prevailing rates in the electrical utility industry. Defendant's answer, denying plaintiffs' allegations, was filed on August 23, 1972. Plaintiffs' motion for summary judgment was filed March 27, 1974. Defendant's cross motion for summary judgment was filed September 10, 1974.

We shall now turn to the first and primary issue in this case: Whether plaintiffs, who are wage board employees of Bonneville, are entitled to 25 per cent premium pay for working on Sunday pursuant to Public Law 89-504, 5 U.S.C. § 5544(a), enacted July 18, 1966.

In order to fully understand the statutory construction problem presented in this case, it is necessary to have a clear picture of the creation of Bonneville in 1937 and of the events which took place thereafter until the passage of the Act of October 23, 1945 (hereinafter the 1945 Act). These facts are well summarized in the defendant's brief and since plaintiffs do not dispute these basic facts, we shall quote from Defendant's Cross Motion for Summary Judgment, at pp. 9a-14 (footnotes and emphasis omitted):

> Bonneville's organic legislation, enacted in 1937, originally provided:
>
> "Sec. 10. The Administrator, the Secretary Of War, and the Federal Power Commission, respectively, shall

appoint such attorneys, engineers, and other experts as may be necessary for carrying out the direction [sic: functions] entrusted to them under the [sic: this] Act, without regard to the provisions of the civil service laws and shall fix the compensation of each of such attorneys, engineers and other experts at not to exceed $7,500 per annum; and they may, subject to the civil service laws, appoint such other officers and employees as may be necessary to carry out such functions and fix their salaries in accordance with the Classification Act of 1923, as amended. (59 Stat. 547)" [sic; 50 Stat. 731, 736]

During the initial years of operation, Bonneville experienced problems in recruiting and retaining the skilled and semi-skilled workmen essential for operation of its complex facilities. Bonneville was a utility competing directly with industry and private utilities in the Pacific Northwest for these workmen. It found it could not compete.

Private utilities paid time and one-half for overtime. Bonneville could not. Private utilities paid a minimum of two hours pay when an employee was called back because of an emergency. Bonneville could not. Private industry paid a night differential. Bonneville could not. Private utilities which did not pay a night differential effectively increased pay by allowing eight hours pay for seven and one-half hours' work. Bonneville could not. Private utilities paid for time its employees spent in travel required by system emergencies. Bonneville could not. Bonneville could pay only for time actually worked and time spent in traveling was, and generally still is, not considered work under the rules applicable to Government employees. Private utilities could pay daily overtime and paid time and one-half for all Sunday overtime. Bonneville could not. Under temporary war powers Bonneville met this practice. But this authority was temporary and upon expiration the controlling law was Section 23 of the 1934 Independent Offices Appropriation Act, Act of March 28, 1934, 48 Stat. 509, 522, (then codified as 5 U.S.C. § 673c) (See 20 Comp. Gen. 392 (1940)). Under that statutory provision payment of overtime for wage board employees was limited to those hours worked in excess of 40 hours per week.

In 1945, to ameliorate many of its problems, Bonneville went to Congress seeking extraordinary authority to enable it to successfully compete within the utility industry in the Pacific Northwest. It was successful in having H.R. 2690 enacted as Public Law No. 201, 79th

Cong., 1st Sess. (1945).[1] This legislation was justified in part before the House of Representatives by the then General Counsel for Bonneville. He testified:

"The Bonneville Power Administration is not carrying out a government regulatory program. It is engaged in a large scale business enterprise * * *.

"Ordinary Government procedure was not designed for use in a business operation of that nature and magnitude, and it has hampered the Administrator to an unwarranted extent. H.R. 2690 and H.R. 2693 are based on the premise that Bonneville is a regional and business agency, and they will permit it to operate in a more businesslike manner * * *.

"Because of the nature of the business in which the Administrator is engaged, his activities are constantly being compared with those of private utilities and private contractors. With respect to labor practices he suffers by comparison. The Administration operates and maintains electric facilities and occasionally undertakes construction work on force account. He should be able to follow the same, or comparable, labor practices as do private utilities and contractors in the same work. H.R. Rep. No. 2690, 79th Cong., 1st Sess. 3 (1945)."

(Similar comments appear in the Senate and House Reports on H.R. 2690 (S. Rep. No. 469, 79th Cong., 1st Sess. (1945); H. Rep. No. 777, 79th Cong., 1st Sess. (1945)).

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[1] Said act as pertinent herein reads as follows:

"*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That section 2 (f) of the Act of August 20, 1937 (50 Stat. 731), as amended by the Act of March 6, 1940 (54 Stat. 47), is hereby amended to read as follows:

* * * * *

"SEC. 5. Section 2 (a) of the said Act is hereby amended by striking the language inserted by section 1 of the Act of March 6, 1940 (54 Stat. 47); and section 10 of the said Act is hereby amended to read as follows:

* * * * *

"'(b) The Administrator, the Secretary of War, and the Federal Power Commission, respectively, are authorized to appoint, subject to the civil-service laws, such officers and employees as may be necessary to carry out the purposes of this Act, the appointment of whom is not otherwise provided for, and to fix their compensation in accordance with the Classification Act of 1923, as amended. The Administrator may employ laborers, mechanics, and workmen in connection with construction work or the operation and maintenance of electrical facilities (hereinafter called 'laborers, mechanics, and workmen'), subject to the civil-service laws, and fix their compensation without regard to the Classification Act of 1923, as amended, and any other laws, rules, or regulations relating to the payment of employees of the United States except the Act of May 29, 1930 (46 Stat. 468), as amended, to the extent that it otherwise is applicable." * * *

* * * * *

Congress recognized the unique status of Bonneville and by the 1945 amendments Bonneville obtained the extraordinary authority required. The Administrator was granted the right to modify, adjust, cancel or compromise contracts or agreements he entered under the Bonneville Act. He could settle, compromise or pay claims against Bonneville arising out of the acts of employees. He could accept voluntary services. And, for the purpose of this action the most significant change, he could:

> "* * * [E]mploy laborers, mechanics, and workmen in connection with construction work or the operation and maintenance of electrical facilities (hereinafter called 'laborers, mechanics and workmen') subject to the civil service laws, and fix their compensation without regard to the Classification Act of 1923, as amended, and any other laws, rules, or regulations relating to the payment of employees of the United States, except the Act of May 29, 1930 (46 Stat. 468), as amended, to the extent that it otherwise is applicable * * *."

Since 1945 Bonneville has thus had the latitude and authority necessary to provide fair and equitable compensation for its hourly employees, including plaintiffs, at rates consistent with those paid in the utility area it served even if this should be inconsistent with pay practices for other federal employees. This authority was granted by Congress with the full realization that Bonneville sought to deviate substantially from the usual pay practices of the Federal Government. It was special legislation enacted to enable Bonneville to function as and compete for employees with private electrical utilities in the Pacific Northwest.

We now leave the 1945 Act and discuss an act of Congress passed in 1949 known as the Classification Act of 1949 (Act of October 28, 1949, 63 Stat. 954). The act as material herein provides as follows:

> TITLE I—DECLARATION OF POLICY
>
> SEC. 101. It is the purpose of this Act to provide a plan for classification of positions and for rates of basic compensation whereby——
>
> (1) in determining the rate of basic compensation which an officer or employee shall receive, (A) the principle of equal pay for substantially equal work shall be followed, and (B) variations in rates of basic compensation paid to different officers and employees shall be in proportion to substantial differences in the difficulty,

> responsibility, and qualification requirements of the work performed and to the contributions of officers and employees to efficiency and economy in the service; and
>
> (2) individual positions shall, in accordance with their duties, responsibilities, and qualification requirements, be so grouped and identified by classes and grades, as defined in section 301, and the various classes shall be so described in published standards, as provided for in title IV, that the resulting position-classification system can be used in all phases of personnel administration.
>
> TITLE II—COVERAGE AND EXEMPTIONS
>
> SEC. 201. (a) For the purposes of this Act, the term "department" includes (1) the executive departments, (2) the independent establishments and agencies in the executive branch, including corporations wholly owned by the United States, (3) the Administrative Office of the United States Courts, (4) the Library of Congress, (5) the Botanic Garden, (6) the Government Printing Office, (7) the General Accounting Office, (8) the Office of the Architect of the Capitol, and (9) the municipal government of the District of Columbia.
>
> (b) Subject to the exemptions specified in section 202, and except as provided in sections 204 and 205, this Act shall apply to all civilian positions, officers, and employees in or under the departments.
>
> SEC. 202. This Act (except title XII) shall not apply to—
>
> * * * * *
>
> (7) employees in recognized trades or crafts, or other skilled mechanical crafts, or in unskilled, semiskilled, or skilled manual-labor occupations * * * whose compensation shall be fixed and adjusted from time to time as nearly as is consistent with the public interest in accordance with prevailing rates;
>
> * * * * *

Section 1204 of the said Classification Act of 1949 further states:

> All laws or parts of laws inconsistent with this Act are hereby repealed *to the extent of such inconsistency.* [Emphasis supplied.]

Relying on said section 1204, plaintiffs' main thrust in this case is (we quote specifically from Plaintiffs' Brief in Support of Plaintiffs' Motion for Summary Judgment, at pp. 34–35):

> That portion of the Act of October 23, 1945, which authorized the Administrator of Bonneville to fix wages of "laborers, mechanics, and workmen * * * without regard to the Classification Act of 1923, as amended, and any other laws, rules or regulations relating to the payment of employees of the United States" is as inconsistent with the Classification Act and the wage board exemption clause in section 202(7) as the special authority of the Alaska Railroad or the Virgin Islands Corporation. The Congress did not see fit to exclude Bonneville as an agency, and therefore, its white collar employees were automatically subject to the Classification Act (which they are) and its wage board employees fell into the general exemption clause in section 202(7). *Being exempted by section 202(7) automatically subjects these wage board employees to the provisions of section 5544(a) requiring that regular Sunday duty be paid for at premium rates.* [Emphasis plaintiffs'.]

Plaintiffs' reference to section 5544(a) is 5 U.S.C. § 5544(a) (1966), which was amended by section 405(f) of the Act of July 18, 1966 (80 Stat. 298). The amendment was as follows:

> The first paragraph of section 23 of the Independent Offices Appropriation Act, 1935, as amended (5 U.S.C. 673c), is amended by inserting immediately before the period at the end thereof the following: ": *Provided further*, That employees subject to this section whose regular work schedule includes an eight-hour period of service any part of which is within the period commencing at midnight Saturday and ending at midnight Sunday shall be paid extra compensation at the rate of 25 per centum of his hourly rate of basic compensation for each hour of work performed during that eight-hour period of service".

Defendant's reply to plaintiffs' foregoing thrust is as follows (quoting from Defendant's Reply to Plaintiffs' Response to Defendant's Cross Motion for Summary Judgment, at p. 7):

> Plaintiffs claim the authority given to Bonneville in 1945 by the Congress is inconsistent with that set forth in Section 202(7) of the 1949 Classification Act (Pltfs' Reply Br., p. 13). Plaintiffs, however, cite no provision of the 1949 Classification Act which is inconsistent with

> the extraordinary authority granted to Bonneville in 1945. All Section 202(7) of the 1949 Classification Act does is exclude skilled and semi-skilled workmen whose wages are fixed in accordance with prevailing rates consistent with the public interest. Nothing more. Where is the inconsistency? Plaintiffs were excluded from the Classification Act of 1923, and as a result of Section 202(7) were specifically exempted from the Classification Act of 1949. [Footnote omitted.]

Plaintiffs' counsel well argued the case before this court but when questioned specifically as to what is the inconsistency, his reply was not satisfactory. Plaintiffs' briefs do not specifically point to any inconsistency.

We agree with defendant for reasons hereinafter stated and hold that there is no inconsistency. Therefore, the 1945 law (Section 10(b) of the Bonneville Project Act) was not repealed and as amended by the Classification Act of 1949, reads as follows:

> * * * The Administrator may employ laborers, mechanics and workmen in connection with construction work or the operation and maintenance of electrical facilities * * *subject to the civil service laws, and fix their compensation without regard to the Classification Act of 1949,[2] *and any other laws, rules, or regulations relating to the payment of employees of the United States.* * * * [Emphasis supplied.]

We emphasize the portion which reads "without regard to * * * *any other laws, rules, or regulations relating to the payment of employees of the United States*" because the 1966 act which provided the 25 per cent for extra work on Sundays is a law relating to the payment of employees of the United States. Therefore, the result is plaintiffs' wages may be fixed without regard to the said 1966 act.

Plaintiffs' first and strongest argument in their opening brief was to point to the 1958 text of section 832i(b) of title

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[2] The 1945 Act originally read "Classification Act of 1923" but Section 1106 of the 1949 Classification Act provided that references to the Classification Act of 1923 should henceforth be considered to mean the "Classification Act of 1949."

16, United States Code, and the historical note following section 832i.[3] The 1958 text as noted in the historical note omits:

> Provisions of subsec. (b) which authorized the Administrator to fix the compensation of laborers, mechanics and workmen without regard to the civil-service laws and any other laws, rules, or regulations relating to the payment of employees of the United States * * *.

Since 16 U.S.C. § 832 and subparagraphs (a) to (l) thereunder, listed as Chapter 12B, specifically refer to the Bonneville Project only, plaintiffs naturally were led to believe that said section 832i(b) as codified and recited in footnote 3 was the present amended status of the statute. But errors do occur in codification and where there is a conflict between the codification and the Statutes at Large, the Statutes at Large must prevail.[4] We held in *American Export Lines, Inc.* v. *United States*, 153 Ct. Cl. 201, 207, 290 F. 2d 925, 929 (1961):

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[3] "The Administrator, the Secretary of the Army, and the Federal Power Commission, respectively, are authorized to appoint, subject to the civil-service laws, such officers and employees as may be necessary to carry out the purposes of this chapter, the appointment of whom is not otherwise provided for, and to fix their compensation in accordance with the Classification Act of 1949. The Administrator may employ laborers, mechanics, and workmen in connection with construction work or the operation and maintenance of electrical facilities (hereinafter called 'laborers, mechanics, and workmen'), subject to the civil-service laws. The Administrator is further authorized to employ physicians, under agreement and without regard to civil-service laws or regulations, to make physical examinations of employees or prospective employees who are or may become laborers, mechanics, and workmen. The Administrator, the Secretary of the Army, and the Federal Power Commission, respectively, are also authorized to appoint, without regard to the civil-service laws, such experts as may be necessary for carrying out the functions entrusted to them under this chapter."

The historical note following section 832i states:

"*References in Text.* The civil-service laws, referred to in the text, are classified generally to Title 5, Executive Departments and Government Officers and Employees.

"The Classification Act of 1949, referred to in the text, is classified to chapter 21 of Title 5.

* * * * *

"*Codification.* The Department of War was designated the Department of the Army and the title of the Secretary of War was changed to Secretary of the Army by section 205(a) of act July 26, 1947, ch. 343, title II, 61 Stat. 501. Section 205(a) of act July 26, 1947, was repealed by section 53 of act Aug. 10, 1956, ch. 1041, 70A Stat. 641. Section 1 of act Aug. 10, 1956, enacted 'Title 10, Armed Forces' which in sections 3011–3013 continued the military Department of the Army under the administrative supervision of a Secretary of the Army.

"Provisions of subsec. (b) which authorized the Administrator to fix the compensation of laborers, mechanics and workmen without regard to the civil-service laws and any other laws, rules, or regulations relating to the payment of employees of the United States and which authorized the Administrator, the Secretary of the Army and the Federal Power Commission to fix the compensation of experts without regard to the Classification Act of 1949, were omitted since the positions referred to are now in the classified civil service and subject to the applicable compensation schedules."

> It is well settled that "the Code cannot prevail over the Statutes at Large when the two are inconsistent." * * *

So the fact that 16 U.S.C. § 832i(b) as it is now codified eliminated the clause "fix the compensation of laborers, mechanics and workmen without regard to the civil-service laws and any other laws, rules, or regulations relating to the payment of employees of the United States" is not controlling. The basic question still is whether the 1945 Act is inconsistent with the Classification Act of 1949.

Plaintiffs argue that there was a repeal by implication and give various reasons for the implication. As a general rule, repeals by implication are not favored. *Universal Interpretive Shuttle Corp.* v. *Washington Metropolitan Area Transit Comm'n*, 393 U.S. 186 (1968); *Jones* v. *Alfred H. Mayer Co.*, 392 U.S. 409 (1968); *United States* v. *Zacks*, 375 U.S. 59 (1963); *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *Federal Trade Comm'n* v. *A.P.W. Paper Co.*, 328 U.S. 193 (1946); *Posadas* v. *National City Bank*, 296 U.S. 497 (1936); *Ely* v. *Velde*, 451 F. 2d 1130 (4th Cir. 1971).

Within the past six months the Court in *Regional Rail Reorganization Act Cases*, 419 U.S. 102 (1974), has stated at pp. 133–34:

> In sum, we cannot find that the legislative history supports the argument that the Rail Act should be construed to withdraw the Tucker Act remedy. The most that can be said is that the Act is ambiguous on the question. In that circumstance, applicable canons of statutory construction require us to conclude that the Rail Act is not to be read to withdraw the remedy under the Tucker Act.
>
> One canon of construction is that repeals by implication are disfavored. See, *e.g.*, *Mercantile National Bank*

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[4] It has been held that even codification into positive law will not give the code precedence where there is a conflict between the codification and the Statutes at Large. *United States* v. *Welden*, 377 U.S. 95 (1964) (n. 4); *Stephan* v. *United States*, 319 U.S. 423 (1943); *Warner* v. *Goltra*, 293 U.S. 155 (1934); *Nashville Milk Co.* v. *Carnation Co.*, 238 F. 2d 86 (7th Cir. 1956), *aff'd* 355 U.S. 373 (1958); *Royer's, Inc.* v. *United States*, 265 F. 2d 615 (3rd Cir. 1959). The codification is only prima facie evidence of the law. 1 U.S.C. § 204(a) (1970).

v. *Langdeau*, 371 U.S. 555, 565 (1963); *United States* v. *Borden Co.*, 308 U.S. 188, 198, 199 (1939); *Amell* v. *United States*, 384 U.S. 158, 165–166 (1966). Rather, since the Tucker Act and the Rail Act are "capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Morton* v. *Mancari*, [417] U.S. [535], [551] (1974). Moreover, the Rail Act is the later of the two statutes and we agree with the Special Court that

> "A new statute will not be read as wholly or even partially amending a prior one unless there exists a 'positive repugnancy' between the provisions of the new and those of the old that cannot be reconciled. * * * This principle rests on a sound foundation. Presumably Congress had given serious thought to the earlier statute, here the broadly based jurisdiction of the Court of Claims. Before holding that the result of the earlier consideration has been repealed or qualified, it is reasonable for a court to insist on the legislature's using language showing that it has made a considered determination to that end. * * *" [384] F. Supp., at [943].

The Court in *Morton* v. *Mancari*, 417 U.S. 535, 550–51 (1974) also regarding repeal by implication stated:

> This is a prototypical case where an adjudication of repeal by implication is not appropriate. The preference is a longstanding, important component of the Government's Indian program. The anti-discrimination provision, aimed at alleviating minority discrimination in employment, obviously is designed to deal with an entirely different and, indeed, opposite problem. Any perceived conflict is thus more apparent than real.
>
> In the absence of some affirmative showing of an intention to repeal, the only permissible justification for a repeal by implication is when the earlier and later statutes are irreconcilable. *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439, 456–457 (1945). Clearly, this is not the case here. * * *
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> * * * * *
>
> The courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective. "When there are two acts upon the same subject, the rule is to give effect to both if possible. * * * The intention of the legislature to repeal 'must be clear and manifest.'" *United*

*States* v. *Borden Co.*, 308 U.S. 188, 198 (1939). In light of the factors indicating no repeal, we simply cannot conclude that Congress consciously abandoned its policy of furthering Indian self-government when it passed the 1972 amendments.

This court in *Casman* v. *United States*, 143 Ct. Cl. 16, 20, 181 F. Supp. 404, 406 (1958), stated:

> It is a familiar rule that repeal by implication is found only by reason of necessity, and repeals by implication are consistently frowned upon. * * *

We must also remember that it is a recognized rule that special statutes will prevail over general statutes without regard to the priority of enactment. *General Dynamics Corp.* v. *United States*, 163 Ct. Cl. 219, 324 F. 2d 971 (1963); *General Motors Corp.* v. *United States*, 155 Ct. Cl. 267, 292 F. 2d 502 (1961); *Panama Canal Co.* v. *Anderson*, 312 F. 2d 98 (5th Cir. 1963), *cert. denied*, 375 U.S. 832; *Fourco Glass Co.* v. *Transmirra Products Corp.*, 353 U.S. 222 (1957); *Bulova Watch Co.* v. *United States*, 365 U.S. 753 (1961); *United States* v. *Nix*, 189 U.S. 199 (1903). In *Morton* v. *Mancari*, *supra* at 550–51, the Court clearly stated the rule:

> Furthermore, the Indian preference statute is a specific provision applying to a very specific situation. The 1972 Act, on the other hand, is of general application. *Where there is no clear intention otherwise, a specific statute will not be controlled or nullified by a general one, regardless of the priority of enactment.* See, *e.g.*, *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 758 (1961); *Rodgers* v. *United States*, 185 U.S. 83, 87–89 (1902). [Emphasis supplied.]

The legislative history of the 1945 amendments to the Bonneville Project Act demonstrates Bonneville was given special authority in matters of employees' pay not subject to the 1923 Classification Act. As the 1949 Classification Act was only a substitute for the earlier act and did not specifically repeal the 1945 special legislation amending the Bonneville Project Act, Bonneville's employees are still excepted from that act by Section 10(b) of the Bonneville Project Act. As above stated, special statutes will prevail over general ones without regard to priority of enactment.

During the argument and in their briefs, plaintiffs relied very much on a 1959 decision of the Comptroller General, reported in 38 Comp. Gen. 538 (1959), which stated at 542 that laborers and mechanics of Bonneville:

> * * * are excepted from the Classification Act of 1949 by reason of paragraph (7) of section 202 of that act and not by the provisions of section 10 of the act of August 20, 1937, as amended, 16 U.S.C. 832i(b) * * *.

The question involved in that decision was whether Public Law 85-872 (now 5 U.S.C. § 5343 (1966)), which required wage determinations made by wage boards to be implemented within 45 days, was applicable to increases in compensation which were granted as a result of collective bargaining under labor management agreements entered into by the following agencies in the Department of the Interior:

Alaska Railroad
Bonneville Power Administration
Southwestern Power Administration
Bureau of Mines
Bureau of Reclamation

The Comptroller General solicited the opinion of the Civil Service Commission (hereinafter CSC) which, under Section 203 of the Classification Act of 1949 (5 U.S.C. § 5103 (1966)), was "authorized and directed to determine finally the applicability of Sections 201 and 202" of the act. The CSC answered as shown below.[5] Plaintiffs argue that the CSC ruled that Section 202(7) of the Classification Act of 1949 is the authority for fixing wage rates for Bonneville wage board employees. We do not agree. We interpret the CSC's views to mean that under the circumstances in which it arose, Bonneville employees were excluded from the coverage of the 1949 Classification Act by Section 202(7) of that act. That is all the Comptroller General ruled. The whole superseding argument of the CSC circulates around an obviously misguided interpretation of Section 1106(a) of the Classification Act of 1949. Section 1106(a) reads as follows:

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[5] "* * * The Commission believes that this provision [referring to 10(b) of the Bonneville Project Act as amended, Section 5b of the Act of October 23, 1945] was superseded by the Classification Act of 1949.

"Section 201(b) of the Classification Act of 1949 provides that 'Subject to the exemptions specified in section 202, and except as provided in sections 204 and 205, this Act shall apply to all civilian positions, officers, and employees in or under the departments.' Attention is also invited to the provisions of section 1106 of the Act:

'(a) Whenever reference is made in any other law to the Classification Act of 1923, as amended, such reference shall be held and considered to mean this Act.' * * *

* * * * *

"Thus *all exceptions* from the Classification Act of 1923 were superseded by the 1949 Act, and no exceptions from the 1949 Act were made unless they were specified in section 202. * * *

* * * * *

"Accordingly, it is our view that laborers and mechanics of the Bonneville Power Administration *are excepted* from the Classification Act of 1949 by reason of section 202(7) of that act." * * * [Emphasis supplied.]

> (a) Whenever reference is made in any other law to the Classification Act of 1923, as amended, such reference shall be held and considered to mean this Act.

The CSC interprets this simple section as superseding all exceptions to the Classification Act of 1923. The CSC concluded that since references to the Classification Act of 1923 mean the Classification Act of 1949, any exceptions referring to the 1923 act would only be exceptions to the 1949 act if listed as exceptions in that act. This is an unreasonable reading of Section 1106(a). Our interpretation is that all Section 1106(a) is doing is substituting the "Classification Act of 1949" for the "Classification Act of 1923" wherever reference to the "Classification Act of 1923" appears in any other statute. (See footnote 2.) This is the only reasonable interpretation of Section 1106(a). The CSC interpretation is misguided. It is significant that the misguided language of the CSC that the 1945 Act of Bonneville was "superseded" by the Classification Act of 1949 was not incorporated into the Comptroller General's opinion. Even though disregarded by the Comptroller General, plaintiffs urge the misguided "superseding" language of the CSC as controlling in this case. We cannot agree with plaintiffs.

The dissent expresses a view that Section 203 of the Classification Act of 1949 forecloses this court's superseding the CSC's interpretation. It is our view that the determination of whether a subsequent statute has, by implication, repealed a prior one is for the courts. *District of Columbia* v. *Hutton*, 143 U.S. 18, 27–28 (1892); *United States* v. *Claflin*, 97 U.S. 546, 549 (1878). Furthermore, in *Scroggins* v. *United States*, 184 Ct. Cl. 530, 533–534, 397 F. 2d 295, 297, *cert. denied*, 393 U.S. 952 (1968), this court in dealing with language similar to the language used in the case in a parallel situation involving the CSC stated as follows:

> The Retirement Act provides (5 U.S.C. § 8347 (1964 Supp. II), formerly 5 U.S.C. § 2266) that "the Commission shall determine questions of disability and dependency" and its decisions "concerning these matters are final and conclusive and are not subject to review." This is a special and unusual restriction on judicial examination, and under it courts are not as free to review Commission retirement decisions as they would be if the "finality" clause were not there. We have said that, at best, a court can set aside the Commission's determination "only where there has been a substantial departure from important procedural rights, *a misconstruction of the governing legislation*, or some like error 'going to the heart of the administrative determination.'" *Gaines* v. *United States*, 158 Ct. Cl. 497, 502, *cert. denied*, 371 U.S. 936 (1962). * * * [Emphasis supplied.]

In the present case the CSC determination was clearly "a misconstruction of the governing legislation."

Defendant submits two additional decisions of the Comptroller General:

> (1) The St. Lawrence Seaway Development Corporation decision (46 Comp. Gen. 176 (1966)) holding that the Seaway's practice of paying a 50 per cent premium for Sunday work had to be discontinued after the 1966 25 per cent Sunday premium law came into effect.
>
> (2) The Veterans Administration decision of May 1, 1972, identified as B-175452, concerning a proposal relative to call-back overtime. The Comptroller held that since 5 U.S.C. § 5542 (1966) provides that "unscheduled overtime work performed by an employee on a day when work was not scheduled for him, or for which he is required to return to his place of employment, is deemed at least 2 hours in duration; * * *", a proposal by the American Federation of Government Employees for 4 hours overtime must be rejected as being not legally acceptable. The ruling was that "2 hours is therefore the maximum that may be paid in the absence of work beyond such period."

These two opinions illustrate exactly why Bonneville was given authority to fix the compensation of its "laborers, mechanics, and workmen * * * without regard to the Classification Act of 1923 [later 1949], as amended, and any other laws, rules or regulations relating to the payment of employees of the United States." At the time the 1945 Act was passed, the primary purpose was to give Bonneville a free hand in competing with the private utility companies in the Northwest region. This was especially so relative to matters relating to holiday pay, Sunday pay, overtime pay, call-back pay and other similar pay matters. This is clearly brought out in the hearings on H.R. 2690 and H.R. 2693, Bills to Amend the Bonneville Project Act (H.R. 2690 was passed October 23, 1945). C. Girard Davidson, General Counsel of Bonneville, testified as shown below.[6] A careful reading of

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[6] "Ordinary Government procedure was not designed for use in a business operation of that nature and magnitude, and it has at times hampered the Administrator to an unwarranted extent. H. R. 2690 and H. R. 2693 are based on the premise that *Bonneville is a regional and business agency* and they would permit it to operate in a more business like manner.

* * * * *

"Most of the labor practices with which the Administrator cannot at present conform, and which put him in an unfortunate position in the present labor market, relate directly or indirectly to the compensation received by employees.

* * * * *

"1. Holiday pay: Bonneville can pay only straight time on holidays whereas private employers pay their employees time and one half for the same work. The difficulty is accentuated by the fact that Bonneville employees receive straight time on holidays within their regular tour of duty whether or not they work.

"2. *Daily overtime: Bonneville can pay overtime only after 40 hours have been worked in one week.* Under normal conditions it cannot pay overtime for more than 8 hours work in 1 day as do private utilities and contractors. Under the Government's broad war powers Bonneville is able to pay overtime for hours worked in excess of eight per day, but that authority, of course, is temporary.

"3. Emergency and call work: When an employee is called to work because of an emergency such as the breaking of a line, private utilities pay for a minimum of 2 hours regardless of whether an employee works a lesser time. Similar minimum payments are made for longer periods. Bonneville is unable to pay its employees on the same basis.

"4. Night differential: Bonneville cannot pay higher rates for night shifts as is done by some private employers.

"5. Multiple shifts: Other private employers and most private utilities do not pay a higher rate for night shifts, but accomplish night differential by allowing 8 hours pay for 7½ hours' work on the late shifts. Bonneville is unable to make such adjustments.

"6. Sunday overtime: Under the 40-hour statute Bonneville can pay overtime on Sundays only for time actually worked, not for travel. If an emergency develops at a distance from an employee's station, the employee can be paid only straight time while he is traveling from his station to the point of emergency, and then only if the travel occurs during his regular tour of duty. He may be paid time and one-half for the time he actually works at the point of emergency. Private utilities pay time and one-half for travel time as well as actual working time under similar conditions.

"Differences and discriminations such as those outlined naturally breed dissatisfaction and contribute to unsatisfactory labor relations. It is but a step further to active opposition by employees and labor, generally, to the activities the quoted testimony strengthens the defendant's argument that the 1945 Act was not only sensible but its purpose, to enable Bonneville to be in competition with private utilities in its labor-management problems, must be carried out.

One of defendant's arguments which plaintiffs have not been able to answer is that plaintiffs' position that there was an implied repeal is at direct odds with subsequent pronouncements by Congress. Defendant has incorporated into his moving brief a 70-page Report No. 192 of the Senate, 82nd Congress, 1st Session, entitled Labor-Management Relations in the Bonneville Power Administration, dated March 21, 1951. The Classification Act of 1949 was enacted October 28, 1949. Plaintiffs claim that the act repealed Section 10(b) of the 1945 Act. This Senate Report made only 17 months after the passage of the Classification Act of 1949, at p. 15, recites Section 10(b) of the 1945 Act:

> * * * The Administrator may employ laborers, mechanics, and workmen in connection with construction work on the operation and maintenance of electrical facilities (hereinafter called "laborers, mechanics, and workmen"), subject to the civil-service laws, and fix their compensation without regard to the Classification Act of 1923, as amended, and any other laws, rules, or regulations relating to the payment of employees of the United States * * *.

And with relation to said 1945 Act, the Report states as follows:

> Part of the legislation just cited was brought into being in 1945, when the Bonneville Project Act was amended through Public Law 201, Seventy-ninth Congress, chapter 433, first session, when BPA found itself confronted with dissatisfaction on the part of its hourly and trade employees. The act creating BPA proved inadequate in meeting conditions confronting it. It did not make for good relations between labor and management. The 1945 amendments and other sections as dealt with in section V of this report, constituted an effort by Bonneville to correct a bad situation then in existence. [At p. 15.]

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and programs of the administration. The Administrator is engaged in a business enterprise, and *he should be able to conform to labor practices which are customary in that business.* The language suggested for the committee's consideration would permit him to do so." [Before House Comm. on Rivers & Harbors, 79th Cong., 1st Sess., at pp. 9–10.] [Emphasis supplied.]

The Report was laudatory of Bonneville's labor relations program and it specially noted the 1945 changes. In the same session of the 81st Congress which passed the Classification Act of 1949, the Senate also passed Senate Resolution 140 which requested the above-mentioned Report. The Report is a report of the Committee on Labor and Public Welfare of the United States Senate. Since the Report is lengthy and required field studies, its preparation and completion ran into the 82nd Congress. When the Report was completed and issued on March 21, 1951, during the 82nd Congress, 10 out of the then 13 members of the Committee on Labor and Public Welfare were Senators during the 81st Congress. In *Socony Mobil Oil Co.* v. *United States*, 153 Ct. Cl. 638, 646–647, 287 F. 2d 910, 914 (1961), this court stated:

> * * * An expression of opinion as to the meaning of a statute, made some four years after the enactment of the statute by the same Congressional committee which had considered that statute at the time of its enactment, is an important circumstance for consideration in interpreting the statute. *Sioux Tribe of Indians* v. *United States*, 316 U.S. 317, 329.[1] ”

Therefore, we consider it “an important circumstance” that the Report of the Committee did not consider Section 10(b) of the 1945 Act repealed by the Classification Act of 1949. We are aware of circumstances mentioned in the footnote to the above quotation from *Socony Mobil Oil Co.*[7] This case is unlike the cases referred to in the said footnote in that the Report was ordered by the same Congress and session which passed the Classification Act of 1949, and 17 months thereafter the Report clearly treats Section 10(b) of the 1945 Act as still in force. The approval of the Report by the Senate Committee on Labor and Public Welfare of the 82nd Congress, made up of 10 senators (out of 13) of the 81st Congress, is material and must not be taken lightly.

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[7] “[1] *United States* v. *United Mine Workers*, 330 U.S. 258, 281–282, is not to the contrary. That case said only that the opinions of several Senators, some of whom had not been members of the Senate when the legislation in question had been considered, and none of whom had been members of the Committee which had reported the legislation and which opinions were expressed eleven years after the legislation had been passed, could not ‘serve to change the legislative intent of Congress expressed’ when the legislation had been passed. Similarly, *Rainwater* v. *United States*, 356 U.S. 590, 593, indicates only that an interpretation by one Congress of a statute passed by another Congress more than a half century before has ‘very little, if any, significance.’ See also the concurring opinion of Judge Littleton in the *Equitable Life Assurance Society* v. *United States*, 149 Ct. Cl. 316, 322, cert. denied 364 U.S. 829, and *A. P. Green Export Co.* v. *United States*, 151 Ct. Cl. 628.”

In addition to the above-mentioned Senate Report, defendant calls our attention to Public Law 93–454 (October 18, 1974, 93rd Congress, 2nd Session), entitled Federal Columbia River Transmission System Act. The act permits Bonneville to use its revenues for expanding the transmission system and for its operation and maintenance. It also authorizes the Administrator to issue revenue bonds and sell them to the Secretary of the Treasury to help finance construction. The bill contains a bonding limitation of $1.25 billion. Passage of this act better enables Bonneville to meet its responsibilities under the regional Hydro-Thermal Power Program in that it no longer has to rely upon year-to-year funding through Congressional appropriations. Since the act authorizes the issuance of bonds, the act is carefully drawn and the legislation contains the following language:

> * * * The provisions of the Government Corporation Control Act (31 U.S.C. 841 et seq.) shall be applicable to the Administrator in the same manner as they are applied to the wholly owned Government corporations named in section 101 of such Act (31 U.S.C. 846), but *nothing in the proviso of section 850 of title 31, United States Code, shall be construed as affecting the powers granted in subsection (b)(11) of this section and in sections 2(f), 10(b), and 12(a) of the Bonneville Project Act* (16 U.S.C. 832 et seq.). [Emphasis supplied.]

We quote the above fully realizing that the 1974 act is about 25 years after the enactment of the Classification Act of 1949 and fully aware of the passage in footnote 7. But in deciding whether a statute has been repealed by implication, we may consider the consequences of such repeal. *Doolittle* v. *Bryan*, 55 U.S. (14 How.) 563 (1852); *Burnet* v. *Guggenheim*, 288 U.S. 280 (1933); *Baltimore & Phila. Steamboat Co.* v. *Norton*, 284 U.S. 408 (1932); *Farmers Loan & Trust Co.* v. *Minnesota*, 280 U.S. 204 (1930); *Clarke* v. *Rogers*, 228 U.S. 534 (1913). The Court in *Doolittle* noted that courts are especially averse to an implied repeal where a repeal may have an effect of unsettling titles to land. We refer to Public Law 93–454 of 1974 because it is an all-important financing act authorizing the issuance of $1.25 billion in bonds by Bonneville. Technicalities in land titles are similar to technicalities in the issuance of bonds. We are also averse to an implied repeal where a basic bond issuance and authorization act of Bonneville, authorizing issuance of bonds up to $1.2 billion, assumes by specific reference that the powers granted in Section 10(b) of the Bonneville Project Act still exist.

We have attempted to answer all of the major arguments by both parties. Plaintiffs have made other arguments such as limited or temporary authority under Section 10(b) of the 1945 Act, plaintiffs are being denied equal pay for equal work, and others. We have considered all of them but our conclusion stated in the early part of this opinion remains unchanged. Section 10(b) was not repealed by the Classification Act of 1949.

In plaintiffs' amended complaint, plaintiffs allege Sunday premium pay "because the prevailing rates in the industry provide for premium pay for Sunday work" and Bonneville "is required under law and equity to set compensation for plaintiffs in accordance with prevailing rates in the industry." The affidavit of one Cosgrove C. LaBarre, labor relations officer for Bonneville for eight years, filed by defendant, dated February 21, 1973, shows that a survey of pertinent utilities in the Pacific Northwest in 1967 showed no premium payment for regularly scheduled Sunday work. A resurvey was made as late as February, 1973; it also showed that no premium is paid for regularly scheduled Sunday work. The affidavit further states that:

> * * * In the 1967 contract negotiations between Bonneville and the Columbia Power Trades Council, in which I participated directly as the primary spokesman for Bonneville, a contract provision requiring payment of a premium of 25 per centum for work, any part of which was performed on Sunday was proposed by the Council. This was rejected by Bonneville upon the ground that such a premium was not prevailing within the electric utility industry within Bonneville's area of operatións.

Plaintiffs have not filed any counter affidavits answering the affidavit of Cosgrove C. LaBarre. Plaintiffs' claim based on this alternative claim, presented by their amended complaint, must be denied.

Defendant has filed a counterclaim in the event that the plaintiffs should prevail here. Since the plaintiffs have not prevailed, defendant's counterclaim is dismissed.

## CONCLUSION

Based on the reasons given in the opinion, we hereby allow defendant's cross motion for summary judgment and deny plaintiffs' motion for summary judgment. Plaintiffs' amended complaint in *Leroy W. Abell, et al.* v. *United States*, No. 261–72, and the complaint in *Jack R. Barger, et al.* v. *United States*, No. 371–73, are hereby dismissed. Defendant's contingent counterclaim in both actions is also dismissed.

DAVIS, *Judge*, dissenting:

For me the crucial feature of this case is Section 203 of the Classification Act of 1949, 63 Stat. 956, 5 U.S.C. § 5103 (1970), which provides (as it now appears in the Code) that "[t]he Civil Service Commission shall determine *finally* the applicability of section 5102 of this title [§§ 201 and 202 of the 1949 Act] to specific positions and employees, except for positions and employees in the Office of the Architect of the Capitol" [emphasis added]. I take this to mean what it says—that the Civil Service Commission is the final arbiter. There is not the slightest constitutional impediment to such a provision by Congress where the substantive legislation concerns federal employees and the Commission decides in favor of employees' rights. That is what the Commission has explicitly done, with respect to the very question before us, in a case in which its view was officially requested and it had to pass directly on the issue. The court thinks the Commission was wrong, but section 203 seems to me to foreclose our superseding the Commission's position in favor of the employees, at the instance of the employing agency, even though the problem is a legal one. This is, as I see it, the mandate of Congress. Under the law the Bonneville Power Administration was required to follow the Commission's directive favoring the employee. All the decisions holding that there is some sort of judicial review, despite "finality" language comparable to that here, are cases in which the Commission (or other agency) decided adversely to the employee.

518 F. 2d 1298

## THE UNITED STATES v. THE SIOUX NATION OF INDIANS, ET AL.

Appeal No. 16-74

Indian Cl. Comm. Docket No. 74-B
33 Ind. Cl. Comm. 151

[Decided June 25, 1975]*

ON APPEAL FROM THE INDIAN CLAIMS COMMISSION

**Indian claims; appeal from Indian Claims Commission; taking of property; res judicata; moral claims; interest on award.**—In 1950 the Sioux Nation of Indians filed the present claim in the Indian Claims Commission under Sec. 5 of the Indian Claims Commission Act, seeking additional compensation for the taking of their lands in the Black Hills under the Act of February 28, 1877, and later included a claim for compensation for minerals removed by miners before the taking date. The United States has appealed from an interlocutory order of the Commission holding appellant liable for a Fifth Amendment taking of said land, as well as for the removed gold; the Commission also would award interest as part of just compensation. At oral argument, appellant admitted it was only here contesting the interest. In 1942 this court held in *Sioux Tribe of Indians* v. *United States*, 97 Ct. Cl. 613, *cert. denied*, 318 U.S. 789 (1943) (a case instituted under a special jurisdictional act, 41 Stat. 738), that the court had no jurisdiction of moral claims because the act did not authorize suit on such claims, that the act created no new rights but granted jurisdiction of any legal claim that existed previously and removed the bar on the Indians suing, and that the Sioux did not have a valid claim against the United States. The United States contends, *inter alia*, that res judicata bars the Fifth Amendment taking claim and that it never intended to waive this defense in the present litigation. It is *held* that the special jurisdictional act covered the taking claim, that the court in 1942, rightly or wrongly, held on the merits that the Sioux did not have a valid claim against the United States, and that the former decision is a res judicata bar to the present Fifth Amendment taking claim, all of the necessary facts having been pleaded

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*Appellees' petition for certiorari *denied* December 8, 1975.

in the original suit. It is also *held* that since Congress did not waive res judicata defenses in the Indian Claims Commission Act, the Sioux are now restricted to moral claims under clauses (3) and (5) of 25 U.S.C. § 70a on which interest cannot be awarded as part of just compensation. It is also *held* that the record supports the Commission's interlocutory order on the ground of dishonorable dealings (clause (5)), except as to interest, but including the pre-taking removal of gold by miners. The cause is remanded for further proceedings consistent with this opinion.

**Indian claims; fiduciary obligation of Government to Indians; generally.**

[1] Where the United States has assumed an obligation to Indians to exclude trespassers from Indian lands, under fair and honorable dealings, it is liable under such an obligation to compensate the Indians for injuries inflicted by third parties, such as for the pre-taking gold removal by large numbers of prospectors and miners who entered upon the Indians' land without their consent.

United States 🔑 105

**Indian claims; Indian Claims Commission Act; fair and honorable dealings.**

[2] Where the "fair and honorable dealings" clause (5) and the "unconscionable consideration" clause (3) of 25 U.S.C. § 70a cover the same factual situation, resort to clause (5) is appropriate when it simplifies matters by avoiding the necessity to measure whether consideration was conscionable or when impossibility of measurement makes unconscionable consideration inapt.

United States 🔑 105

**Eminent domain; just compensation; right to.**

[3] The right to just compensation in case of an eminent domain taking exists independently of whether the sovereign has provided any forum in which it can be sued.

Eminent Domain 🔑 122

**Judgments; former adjudications; res judicata.**

[4] The bar of res judicata is not lifted if a later court disagrees with a prior one. *Cromwell* v. *County of Sac*, 94 U.S. 351 (1876).

Judgment 🔑 649

**Indian claims; judgments; former adjudications; res judicata.**

[5] In Indian Claims Commission Act proceedings, a former decision on the merits by a court having jurisdiction is a res judicata bar to further litigation of the same claim. Thus, where this court in *Sioux Tribe of Indians* v. *United States*, 97 Ct. Cl. 613 (1942), *cert. denied*, 318 U.S. 789 (1943), before the court pursuant to a special jurisdictional act to determine a taking claim based on violation of priority rights created by treaty, held, on the merits, that the court had no jurisdiction of moral claims because the act did not authorize suit on such claims, that the act created no new rights but

granted jurisdiction of any legal claim that existed previously and removed the bar on the Indians suing, and that the court had jurisdiction of a taking claim but that the Indians failed to prove such a claim in light of established legal principles, the present Fifth Amendment taking claim seeking additional compensation for the same lands is barred under the doctrine of res judicata.

United States ⚿ 112

**Judgments; former adjudications; res judicata; generally.**

[6] The doctrine that even erroneous decisions have res judicata effect is ancient in American law and of highest authority.

Judgment ⚿ 660

**Indian claims; taking of Indian property; compensation for property taken; moral claims; interest.**

[7] Where this court in 1942 held, on the merits, in a cause instituted under a special jurisdictional act, 41 Stat. 738, that the Sioux did not have a valid claim against the United States on account of the taking of Black Hills, and also held that the court had no jurisdiction of moral claims relating to the same matter, since the Congress although waiving other defenses did not waive res judicata defenses in the Indian Claims Commission Act and such defense is applicable in the present Fifth Amendment taking claim, the Sioux are restricted to moral claims under the "unconscionable consideration" clause (3) and the "fair and honorable dealings" clause (5) of 25 U.S.. § 70a, on which interest cannot be awarded as part of just compensation.

United States ⚿ 105

*Craig A. Decker*, with whom was *Assistant Attorney General Wallace H. Johnson*, for appellant.

*Arthur Lazarus, Jr.*, attorney of record for the Pine Ridge Sioux Tribe.

*Marvin J. Sonosky*, attorney of record for the Rosebud Sioux Tribe, Standing Rock Sioux Tribe, Crow Creek Sioux Tribe, Lower Brule Sioux Tribe and Santee Sioux Tribe.

*William Howard Payne*, attorney of record for the Cheyenne River Sioux Tribe and the Sioux of the Fort Peck Reservation, Montana.

Before Cowen, *Chief Judge*, Durfee, *Senior Judge*, Davis, Skelton, Nichols, Kunzig, and Bennett, *Judges*.

Nichols, *Judge*, delivered the opinion of the court:

This appeal of the Indian Claims Commission's interlocutory order of February 15, 1974, raises essentially the question whether by the Act of February 28, 1877, 19 Stat. 254, and otherwise, the United States took the Sioux Nation's property in the Black Hills, South Dakota, by the power of eminent domain, or by a course of unfair and dishonorable dealing not amounting to a constitutional taking. In the former case interest is awardable as a part of just compensation and that is the answer of the Commission. In the latter it is not, and that is ours. Appellant admitted on oral argument it was only here to contest the interest. The following colloquy occurred:

> Judge DAVIS: * * * The difference really is, whether the Tribes will be entitled to interest on whatever the valuation is? The Commission came up with
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> Gov't. Atty.: 17 million dollars
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> Judge DAVIS: Now, originally you were able to take it to wipe out the whole 17 million but now you're no longer able to do that?
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> Gov't Atty.: Not on unconscionable consideration.
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> Judge DAVIS: But now the whole difference is interest, whether they get paid the interest?
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> Gov't Atty.: That's all we're arguing about.

The opinion below, 33 Ind. Cl. Comm. 151, reveals the facts giving rise to the instant claim. By the Treaty of April 29, 1868, 15 Stat. 635, 636, the United States confirmed in the Sioux Nation recognized title to all of the present South Dakota West of the Missouri River, and it agreed to keep unauthorized persons out. The Black Hills portion, acquired in 1877, contained 7,345,157 acres. In 1874 an exploration led by Lieutenant Colonel Custer discovered gold in this area. A large number of prospectors and miners thereafter entered it without consent of the Indians or other warrant of law, and pressure began to build to open the Black Hills to white settlement. At first the Army was stationed to keep the intruders out, but by motion of appellee, and without objection by appellant, we take judicial notice of certain documents which show that President Grant on November 3, 1875, secretly ordered the Army to make no further resistance to the miners going in. At the same time, he decided not to rescind orders theretofore issued forbidding them to occupy the Black Hills country, but in the absence of enforcement, this was ineffectual. The dependence of the

Sioux on Government rations was relied on to prevent their making trouble.

The Government now decided to acquire the Black Hills from the Sioux, sending a Commission to negotiate, but it failed to reach agreement. In December 1875, the Government ordered all Sioux back to their reservation by January 31, 1876, or be treated as hostile. Those outside were hunting and could not return in time; nevertheless the Army was sent to commence military operations against them. The famous defeat of Custer occurred on June 25, 1876. Incensed by this, Congress attached a rider to the Appropriation Act of August 15, 1876, cutting off the Sioux rations until they ceded the Black Hills. Since they could not hunt, until they yielded they would starve.

The Commission was unable nevertheless to get more than 10% of adult male Sioux to agree to cession. This was fatal to a legal acquisition by agreement, since Article XII of the 1868 Treaty provided that no cession of any part of the reservation should be valid unless three-fourths consented.

Congress by Act of February 28, 1877, 19 Stat. 254, resolved the impasse by enacting into law the unratified agreement of September 26, 1876. This yielded up the disputed territory. It included provisions respecting a contemplated removal to Indian Territory, not here relevant. It undertook to educate the Sioux and gave them a right to specified rations until able to support themselves. They had to remain impoverished to continue to enjoy the rations, a condition it seems they have satisfied down to the present day. There were also provisions for land allotments on the parts of the reservation not ceded.

Besides valuing the yielded land as of February 28, 1877 at $17,100,000, the Commission determined that the sum of $450,000 would compensate for the gold removed by miners before the taking date.

The instant claim has had a long history and, as an occasion for lawyers' work and effort, a distinguished one. For the Indians, it has been so far unrewarding. We consider it here to the extent necessary to evaluate appellant's *res judicata* defense.

By Act of June 3, 1920, 41 Stat. 738, the Congress provided a special jurisdiction for this court to adjudicate appellees' claims. It enacted:

> * * * That all claims of whatsoever nature which the Sioux Tribe of Indians may have against the United States * * * may be submitted to the Court of Claims * * * for determination of the amount, if any, due said tribe from the United States under any treaties, agreements, or laws of Congress, or for the misappropriation of any of the funds or for lands of said tribe * * * or for the failure of the United States to pay said tribe any money or other property due; and jurisdiction is hereby conferred upon the Court of Claims * * * to hear and determine all legal and equitable claims, if any, of said tribe against the United States, and to enter judgment thereon.
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> Sec. 2. That if any claim or claims be submitted to said courts they shall settle the rights therein, both legal and equitable, of each and all the parties thereto, * * *

The instant claim was presented as one among thirteen, and was dealt with, in a reported decision almost twenty-two years later. *Sioux Tribe of Indians* v. *United States*, 97 Ct. Cl. 613 (1942), *cert. denied*, 318 U.S. 789 (1943). Whether this decision was on the merits, and thus *res judicata* of the claim, or any portion thereof, or whether it merely held the court had no jurisdiction, is the somewhat bizarre question the parties have debated, below and here, and which we must now decide. All the rest of the claims were also dismissed for one reason or another.

After passage of the Indian Claims Commission Act, 25 U.S.C. § 70 and ff., in 1946 the then counsel for the Tribe in 1950 resubmitted the Black Hills claim. The theory then was unconscionable consideration and dishonorable dealings under § 70a (3) and (5). It was assumed then that the 1942 decision did not bar these claims by *res judicata* or collateral estoppel because claims under paragraphs (3) and (5) were new causes of action that were moral in nature and not justiciable under the Special Jurisdictional Act of 1920. Defendant, however, stated in its answer that recovery was denied in the 1942 decision "for want of jurisdiction." Even if defendant had not altered its construction, obviously we would not take the parties' pleadings as binding us as to the meaning of our own reported decision. The Commission entered an order of dismissal and this court published an affirming opinion, 146 F. Supp. 229 (1956). The main reason for the position was that the consideration was not proven unconscionable because the Indians had persisted in trying to prove the value of the property taken from them by an improper method. The Indians by their then counsel admitted they had been paid more than the value of the property on the taking date.

The Indians at this point retained new counsel who obtained an order vacating our judgment of affirmance, for the Commission to reopen the proofs, and to reconsider its former decision if it saw fit to do so. 182 Ct. Cl. 912 (pub. in 1968). The Commission did reopen the proofs and did receive a quantity of new evidence. In 1961 we denied a petition by the Government for mandamus to prevent the Commission allowing the Indians to file an amended petition and for other extraordinary relief. See, *Sioux Tribe* v. *United States*, 205 Ct. Cl. 148, 500 F. 2d 458 (1974).

Since the 1956 decision was withdrawn, we do not now treat it as determinative of anything.

The new decision of the Commission at 33 Ind. Cl. Comm. 151 (1974) is predicated on a theory of a taking by eminent domain, and the Commission would award interest as part of just compensation both for the land and for the pre-taking removal of gold by the miners. The Commission order contemplates a return of the case to it after our review for determination of offsets, but Congress later that year enacted in Pub. L. 93–494, 88 Stat. 1499, that there would not be any offsets for food, rations, or provisions. There are said to have been in contemplation not many other offsets. The Indians we hope are now near the end of the long and weary trail, but how much they realize on the claim turns wholly or almost wholly on the interest question, as it will be obvious, that interest over almost 100 years would many times exceed the principal. If we disagree with the Commission as to its taking theory the findings would justify liability under § 70a(5). The want of fair and honorable dealings seems obvious and this theory will support the award for pre-taking gold removal as well, since under this clause, with an obligation to protect once assumed, injuries inflicted by third parties are compensable. *Aleut Community* v. *United States*, 202 Ct. Cl. 182, 480 F. 2d 831 (1973); *Lipan Apache Tribe* v. *United States*, 180 Ct. Cl. 487 (1967).

In *United States* v. *The Goshute Tribe*, 206 Ct. Cl. 401, 512 F. 2d 1398 (1975), we consider the basis of a dishonorable dealing award under the Act. If the dealings were dishonorable, we held an award under clause (5) to be allowable even though the Commission might have made an award under some other sections also. As we there pointed out, resort to that section simplifies things by avoiding the necessity to measure whether consideration was conscionable. As the Congress does not want the rations to be used as offsets, *a fortiori* they should not come into the case by way of measuring the conscionability of consideration. If such a measurement had to be made, obviously, we think, the value of the expectations of rations in 1877 would be the value to be considered, and it would be impossible to determine that value, antecedently considered, because the Indians would terminate their right to rations whenever they became prosperous. No one in 1877 could have foreseen that the Sioux would always be poor, as the Commission rightly says. Thus impossibility of measurement makes "unconscionable consideration" inapt as a basis for liability.

We mention this court's requirement for a "special relationship" in *Goshute*, if dishonorable dealings liability is found. We say "Such a 'special relationship' arises when United States officials tender a Treaty to Indians for adhesion." 206 Ct. Cl. at 407. A Treaty was tendered the Sioux for adhesion in 1876. However, breach of the obligation to protect the Indians' lands from unwanted intruders, as promised in the 1868 Treaty, reneged on another special relationship. The duplicity of President Grant's course and the duress practiced on the starving Sioux, speak for themselves. A more ripe and rank case of dishonorable dealings will never, in all probability, be found in our history, which is not, taken as a whole, the disgrace it now pleases some persons to believe.

The Commission's taking theory founders on the bar of *res judicata*. As if doubtful of its reading of the 1942 case, the Commission strained to find an abandonment of this defense by the Government. Defendant did say in its pleadings that we held we had no jurisdiction in 1942, but explains it meant we had no jurisdiction of claims that were moral and not legal. Until after the remand by this court, the claim was actively prosecuted on the new moral grounds created by the 1946 Act. The Government shows it gave clear notice that it relied on *res judicata* as to any matters properly before the 1942 court. After 1969, when it was clear the Indians relied on a taking theory, the defendant debated the theory in full reliance on the 1942 case. We think the Commission should have accepted the Government explanation of its pleadings, as do we. When it came to write its decision it was well aware the 1942 decision had not been stipulated out of the case. Our policy, and the Commission's, has been to be lenient with the Indians as to whether their original petition allegations, filed before the jurisdictional cutoff, stated the claim on which they were ultimately to recover. It will not do, in cases under the same Act, to trap the Government in pleading allegations that were at best, ambiguous.

It must be a rare thing for a court to write findings and an opinion totalling 76 pages in length, all just to say it has no jurisdiction. This is, however, the Commission's position as to our 1942 decision. Indeed, the Commission really imputes a gross impropriety to this court in making a whole series of positive pronouncements on the legal rights of the parties—in a case over which it holds it has no jurisdiction! The best refutation would be to set forth the opinion at least, *in toto*, but we cannot on such a scale reprint material already available, in face of our over-large printing bills. It is no longer possible to follow the old practice of making such extensive quotes from prior opinions, as used to be usual. In this instance the opinion to be quoted also contains numerous long quotes from opinions still earlier which of course are all also directly available. Therefore we assume the interested reader will obtain our 1942 opinion. We set forth the rationale of that opinion, as we understand it, and next take up the specific passages that are alleged to reveal an admission of no jurisdiction.

The 1942 court, as we read it, analyzed the claim as moral rather than legal. The opinion starts out by saying the claim is for alleged taking for public purposes, or misappropriation, by defendant. The suit was specifically for just compensation, with interest, for an alleged taking, but the Government Acts relied on did not amount to an exercise of eminent domain in the court's view. The jurisdictional act did not authorize suit on moral claims. All it did was to remove statute of limitation bars, and bars against suits by Indian tribes, on previously existing rights.

The suit could not be maintained as for a taking because the facts brought the case under the line of *Lone Wolf* v. *Hitchcock*, 187 U.S. 553 (1903) and not under the line of *Shoshone Tribe of Indians* v. *United States*, 299 U.S. 476 (1937); 304 U.S. 111 (1938). The former case held that it was not a taking if the Congress, exercising its plenary power over Indian tribes, took their land without their consent and substituted for it something conceived by Congress to be an equivalent. Then it would be presumed that Congress acted in good faith for the Indians' best interests. The Court would inquire into neither the motives of Congress nor the sufficiency of the intended consideration, as to which Congress was the sole judge. The *Shoshone* line was explained as cases where the Indian land was taken and turned over to others without any real or purported equivalent.

Thus it was perfectly correct to say this court held it had no jurisdiction of "unconscionable consideration" and "dishonorable dealing" claims, these being moral and therefore outside the scope of the jurisdictional act. It is not correct to say it held it had no jurisdiction of the taking claim. The Act was broad enough to open the court to any legal claim, but it had to be a legal claim existing independent of the availability of a forum open to suit, for the jurisdictional act neither created nor enlarged pre-existing legal rights. The claim for a taking was well within the jurisdictional act, but the proofs, it was held, showed no taking. It would not have mattered if the jurisdictional act had been broader, so far as the taking claim was concerned. There was just no valid taking claim, whether a tribunal was provided for its enforcement or not.

It is necessary to understand that the right to just compensation in case of an eminent domain taking is conceived by the court to exist independently of whether the sovereign has provided any forum in which it can be sued.

In further explanation of the 1942 decision, it should be said that while refusing to determine the adequacy of the compensation proffered by the Government for the land, the court was manifestly impressed by the found fact that the expenditure for rations for the Sioux had already reached the figure of $43,000,000, a substantial sum in those days. This court, too, in considering the moral claims in the withdrawn 1956 decision, deemed the consideration for the land more than adequate. It never apparently occurred to the court either time that the rations were to compensate, not for the land, but for prior destruction of the Indians' mode of subsistence, as found by the Congress in enacting Pub. L. 93–494, *supra*, *U.S. Code Cong. & Ad. News*, 93d Cong. 2d Sess. 6112–6115 (Senate Rep.) A few years ago this court, in an effort to synthesize the *Lone Wolf* v. *Hitchcock* and the *Shoshone* lines of cases, suggested that in cases of purported exercise of trusteeship control over Indian affairs, and purported substitution of one property right for another, the test to bring a case into the *Lone Wolf* line is whether Congress made a "good faith effort" to ascertain and obtain for the Indians the value of the land. *Three Affiliated Tribes of the Fort Berthold Reservation* v. *United States*, 182 Ct. Cl. 543, 553, 390 F. 2d 686, 691 (1968). In our 1942 decision this test is not articulated, and whether if it had been the same result would have been reached is far from obvious, but need not be and is not considered here, since, as will appear, the bar of *res judicata is* not lifted if a later court disagrees with a prior one.

We now consider the passages in the 1942 decision relied on by the Commission to establish that this court held it had no jurisdiction even of the taking claim.

The first quotation at 33 Ind. Cl. Comm. 199, is from the court's introductory statement at p. 616. It is twisted by the Commission into an admeasurement of our jurisdiction. This quotation from the 1942 opinion says the question is:

> * * * whether, as a matter of law, the plaintiff tribe has

> a legal or equitable claim under section 1 of the Jurisdictional Act * * *

This was not intended as a discussion of the scope of the Act referred to. The court does this elsewhere and shows that in its opinion the special Jurisdictional Act created no new rights but granted jurisdiction of any legal claim that existed previously, and only wanted a tribunal in which the United States consented to be sued. It cannot therefore mean, as the Commission apparently would have it, that section 1 of the Jurisdictional Act is to be looked to as somehow the source of the claim. The court said at p. 666:

> In the case at bar the jurisdictional act, except so far as concerns the competency of the Indian tribe to sue and the limitation on our general jurisdiction under section 259, title 28, U.S.C., as well as the statute of limitation, created no new right or claim in favor of the tribe not otherwise within the limits of our general jurisdiction. * * *

The second quotation, 33 Ind. Cl. Comm. 199, is from p. 658 of the opinion. It says:

> The facts and circumstances narrow the legal issue * * * to the question whether * * * the plaintiff tribe *has any legal and enforceable claim* * * * *upon which the court has authority to inquire into the wisdom of the policy pursued by the Government,* * * * *and the adequacy of the consideration assumed* * * * [Emphasis added by ICC.]

This passage is taken out of context and read with the context it means that once the taking claim is eliminated, all that then remains is whether the court can pursue impermissible inquiries in enforcement of a moral claim. It does not deal with the taking claim based on a violation of property rights created by treaty.

The quote at 33 Ind. Cl. Comm. 200, from the 1942 opinion, at 657–58, is representative but misunderstood. It is worth setting forth in full:

> If the lands or other property rights of plaintiff were misappropriated or taken by the United States *in violation of the treaty of 1868, and contrary to the authority which Congress possessed under the treaty and the law governing the rights of the parties,* without the payment

> of compensation therefor and under such circumstances as to give rise to an implied contract to pay just compensation for the property taken contemporaneously with the misappropriation or taking, plaintiff is entitled to recover. *But if*, under the circumstances disclosed by the record, *Congress acted within the limits of its authority under the law and the treaty* in acquiring the lands and hunting rights for which it made compensation, *the plaintiff is not in our opinion entitled under the terms of the jurisdictional act to recover.* [Emphasis added by ICC.]

This considers both alternatives. If plaintiffs can prove a taking claim, they can recover. But if Congress acted within its legal rights, they cannot. This shows clearly that the special jurisdictional act covered the taking claim, as we now hold.

The quote at 33 Ind. Cl. Comm. 201 explains the jurisdictional act just as we have above, *i.e.*, that it created no new legal right but only removed the bar on the Indians suing.

The first quote at 33 Ind. Cl. Comm. 202 agrees with our analysis, saying that in light of established legal principles the plaintiffs cannot recover as for a taking.

The Commission's second quote on that page is from p. 667 of the court opinion. The court said that the 1868 treaty and the 1877 act are not laws giving a valid foundation to the claim. From this the Commission draws the staggering *non sequitur* that the court believed it had no jurisdiction to hear a claim based on violation of rights the Sioux possessed under the Constitution. Of course, the Fifth Amendment, the part of the Constitution involved, protects property rights made valid by some other law. The Commission cannot think the Fifth Amendment created the property rights it shelters, and surely would not be surprised to learn there were property rights before there was a Fifth Amendment, we are sure.

In its quote from the court opinion, p. 668, at 33 Ind. Cl. Comm. 204 the Commission confuses the jurisdiction of the court with the Indians' "legal right to complain", concepts the court carefully separated, and also confuses the right of the court to pass upon the justness and fairness of what Congress did, *i.e.*, the moral claims, with its right to adjudicate the taking claim, which the court had and exercised.

The series of quotes at 33 Ind. Cl. Comm. 206, 207, need not be analyzed in detail. They all are consistent with our view that the court considered it had jurisdiction of a taking claim, but the Indians failed to prove a taking claim, and that it had no jurisdiction of moral claims, which was all the Indians proved, if they proved anything.

The Commission refers to *Winnebago Tribe of Indians* v. *United States*, 100 Ct. Cl. 1 (1942), as confirming its understanding of the *Sioux* case. It follows the latter case and we think the Commission has misunderstood it in the same way.

See also discussion of the 1942 case in *Sioux Tribe* v. *United States*, 105 Ct. Cl. 725, 776–78 (1946), 64 F. Supp. 312, *on pet. for cert. judgment vacated*, 329 U.S. 685 (1947) reciting over three pages the court's handling of the taking claim in the 1942 case, and nowhere thinking to mention the court refused to take jurisdiction of that claim.

Chairman Kuykendall, dissenting, points to the withdrawn decision, *Sioux Tribe* v. *United States*, 146 F. Supp. 229, 239 (1956), wherein this court, then comprised of four of the judges who sat on the 1942 case, and one other, held that Category (2) claims under the Indian Claims Commission Act, 25 U.S.C. § 70a could not be brought by the Sioux because adjudicated unfavorably to them in the 1942 decision. This gives perhaps cumulative support to a conclusion more comfortably based on other grounds.

It is elementary that in Indian Claims Commission Act proceedings a former decision on the merits by a court having jurisdiction is a *res judicata* bar to further litigation of the same claim. *United States* v. *Southern Ute Tribe*, 402 U.S. 159 (1971); *Assiniboine Indian Tribe* v. *United States*, 128 Ct. Cl. 617, 121 F. Supp. 906, *cert. denied*, 348 U.S. 863 (1954). *Res judicata* was defined in *Cromwell* v. *County of Sac*, 94 U.S. 351, 352–3 (1876), in the following terms by Mr. Justice Field:

> In considering the operation of this judgment, it should be borne in mind, as stated by counsel, that there is a difference between the effect of a judgment as a bar or estoppel against the prosecution of a second action upon the same claim or demand, and its effect as an estoppel in another action between the same parties upon a different claim or cause of action. In the

> former case, the judgment, if rendered upon the merits, constitutes an absolute bar to a subsequent action. *It is a finality as to the claim or demand in controversy*, concluding parties and those in privity with them, *not only as to every matter which was offered and received to sustain or defeat the claim or demand, but as to any other admissible matter which might have been offered for that purpose.* Thus, for example, a judgment rendered upon a promissory note is conclusive as to the validity of the instrument and the amount due upon it, although it be subsequently alleged that perfect defences actually existed, of which no proof was offered, such as forgery, want of consideration, or payment. If such defences were not presented in the action, and established by competent evidence, the subsequent allegation of their existence is of no legal consequence. The judgment is as conclusive, so far as future proceedings at law are concerned, as though the defences never existed. The language, therefore, which is so often used, that *a judgment estops not only as to every ground of recovery or defence actually presented in the action, but also as to every ground which might have been presented, is strictly accurate, when applied to the demand or claim in controversy.* Such demand or claim, having passed into judgment, cannot again be brought into litigation between the parties in proceedings at law upon any ground whatever.
>
> But where the second action between the same parties is upon a different claim or demand, the judgment in the prior action operates as an estoppel only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered. In all cases, therefore, where it is sought to apply the estoppel of a judgment rendered upon one cause of action to matters arising in a suit upon a different cause of action, the inquiry must always be as to the point or question actually litigated and determined in the original action, not what might have been thus litigated and determined. Only upon such matters is the judgment conclusive in another action.
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> The difference in the operation of a judgment in the two classes of cases mentioned is seen through all the leading adjudications upon the doctrine of estoppel. (Emphasis supplied).

This classic comparison of *res judicata* (same claim) and collateral estoppel (different claims) still provides a current, valid definition of *res judicata. Lawlor* v. *National Screen*

*Service Corp.*, 349 U.S. 322, 326 n. 6 (1955); *United States* v. *Moser*, 266 U.S. 236, 241 (1924).

Although hard, the doctrine that even erroneous decisions have *res judicata* effect is ancient in American law and of highest authority. *See*, *Williams* v. *Armroyd*, 11 U.S. (7 Cranch) 423, 432–33 (opinion by Chief Justice Marshall) (1813); *Milliken* v. *Meyer*, 311 U.S. 457, 462 (1940); *Chicot County Drainage District* v. *Baxter State Bank*, 308 U.S. 371, 373–76 (1940).

Nor do any escape hatches appear. Unlike *Lawlor*, *supra*, there is no conduct by the parties subsequent to 1942 to create a new cause of action. And unlike *Oerlikon Machine Tool Works Buehrle & Co.* v. *United States*, 121 Ct. Cl. 616, 102 F. Supp. 417 (1952), vacated on other grounds, 138 Ct. Cl. 457, 151 F. Supp. 332 (1957), all of the necessary facts were pleaded in the original suit.

Since in 1942 this court did, rightly or wrongly, hold on the merits, in a cause it had jurisdiction of, that the Sioux did not have a valid claim against the United States on account of the taking of Black Hills, and since it also held it had no jurisdiction of moral claims relating to the same matter, and since in waiving other defenses the Congress did not waive *res judicata* defenses in the Indian Claims Commission Act, the Sioux are now restricted to moral claims under categories (3) and (5) of Sec. 70a, on which interest cannot be awarded as part of just compensation. The Congress which wiped out the rations offset could correct this situation also, but we are without the power to do so. On the ground of dishonorable dealings under category (5), the record made supports the Commission's Order except as to interest, but including the pre-taking removal of gold by miners. The cause is remanded for further proceedings consistent with this opinion.

*AFFIRMED IN PART, REVERSED IN PART AND REMANDED*

DAVIS, *Judge*, dissenting in part:

I disagree with the court's holding that the decision in 97 Ct. Cl. 613 (1942), *cert. denied*, 318 U.S. 789 (1943), is *res* *adjudicata* of the Fifth Amendment taking claim now presented by the Sioux Nation.[1]

It is not easy to apply the general principles of former adjudication to this court's decision in 97 Ct. Cl., and both sides can readily cite different parts of that opinion which appear to support the respective positions. The key, as I see it, is that the 1942 court separated an Indian Fifth Amendment claim into two distinct parts—the first being whether there was any "taking" or "misappropriation" at all, and the other being the amount of compensation to be paid by the Government for the "taking." The court thought it had power, under the normal jurisdictional act, to determine the former issue but, in considering whether the constitutional measure of "just compensation" had been paid for the "taking", the court felt that it had no competence to weigh or take account of the consideration given the Indians by the United States unless the special jurisdictional act so provided in explicit terms—which in this instance it did not. On this view, the court refused to assess at all the money or value given by the Government in exchange for the Black Hills. It would not decide, because it believed it could not, whether or not this consideration amounted to "just compensation."

The rule we apply today is quite different. In Indian Fifth Amendment cases, we now take account of, and assess, the consideration given by the United States in deciding whether "just compensation" has been given. *Three Affiliated Tribes of the Fort Berthold Reservation* v. *United States*, 182 Ct. Cl. 543, 390 F. 2d 686 (1968); *Klamath and Modoc Tribes* v. *United States*, 193 Ct. Cl. 670, 689 n. 25, 436 F. 2d 1008, 1017 n. 25, *cert. denied*, 404 U.S. 950 (1971); *Confederated Salish and Kootenai Tribes* v. *United States*, 193 Ct. Cl. 801, 805, 437 F. 2d 458, 459–60 (1971). For purposes of *res judicata*, the formal issue thus becomes whether this is simply a change, since 1942, in the substantive law of just compensation for Indians or whether it is attributable to a liberalized view of the authority given the courts by the jurisdictional statutes consenting to suit against the United States on Indian Fifth Amendment claims.

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[1] I concur in the court's other rulings, including that the United States is not precluded from raising the defense of *res judicata.*

This is a difficult question to answer but I prefer the latter response—the so-called "jurisdictional" response[2]—mainly because, in my view, that is the stance taken, on the whole, by the 1942 court. The opinion repeatedly ties its refusal to assess or weigh the consideration (given by the United States) directly to the particular jurisdictional act. *See* 97 Ct. Cl. at 616 (this forms part of the court's opinion, as is made clear by the foreword, on the same page, to the findings of fact), 657–58, 658, 666, 668, 670, 681, 681–82, 682–83, 683, 685. The court also spends some time emphasizing the strict construction to be given to special jurisdictional statutes. *See* 97 Ct. Cl. at 663–65, 682. Implicit in the whole opinion seems to be the notion that, except where consent to suit is given without qualification for suits against Government corporations (97 Ct. Cl. at 664–65), there is both a general presumption against suability of the United States, and also a special presumption against opening up, for judicial scrutiny, Indian claims challenging a congressional policy deemed at the time to be for the welfare of the Indians (97 Ct. Cl. at 665). The court's position was that "when Congress has desired to open up [the latter type of] claims * * * it has used language clearly indicating that purpose" (*Ibid.*).

This symbiotic relationship between the terms of the jurisdictional act and the court's right to inquire into the extent and adequacy of the consideration is brought out, I think, by two sections toward the close of the 1942 opinion. In one the court says (97 Ct. Cl. at 681–82):

> Plaintiff's position in substance is that one party to a proposed transaction cannot legally fix the terms or consideration and force the other party to accept them. This is true in transactions between private parties dealing at arm's length and on terms of equal authority, but this legal proposition does not follow in dealings between the Government and Indian Tribes so as to enable the Indians to question in a legal proceeding the policy, wis-

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[2] If the 1942 decision was based on a lack of jurisdiction in this court, under the then special jurisdictional act, to take account of the consideration transferred by the Government, *res judicata* is inapplicable because, in that case, the earlier court would have felt precluded by a lack of jurisdiction from delving into one of the significant elements of the Fifth Amendment claim. See A.L.I., Restatement of the Law Second Judgments, Tent. Draft No. 1, § 48.1 (1)(a), § 61.2(1)(c), pp. 45, 123, 127–130 (1973).

> dom, or authority of Congress, *unless Congress has clearly granted to the Indians the right to do so* [emphasis added]. In our opinion this has not been done for "the [jurisdictional] act grants a special privilege to the plaintiffs and is to be strictly construed and may not by implication be extended to cases not plainly within its terms"—[citing cases]. To hold otherwise, it would be necessary for us to go back of the acts of August 15, 1876, and February 28, 1877, and inquire into the policy as well as the judgment and wisdom of Congress which prompted it to act as it did and, therefore, adjudicate and render judgment either for or against the Indians on a moral claim. We cannot find that authority in the jurisdictional act.

The second excerpt reads as follows (97 Ct. Cl. at 683–84):

> In reaching this conclusion we have kept in mind the principle of law that while the government always has the right to take or appropriate any private property for a public use, if it does so, without claim of title and without compensation, there arises an implied contract under the Fifth Amendment, and, therefore, a legal claim for just compensation. * * * But before this general rule is applicable to Indian cases, consideration must be given to the question of policy and the extent of the plenary authority of Congress to legislate in such a way as it deems proper with reference to the management and control of the property and affairs of the Indian tribes *and the extent to which consent to be sued has been granted* [emphasis added], as well as to the circumstances and conditions under which an implied contract will arise under the Fifth Amendment. The facts must show *not only* that there has been a "taking" or "misappropriation" by the Government of land or property of the tribe under such circumstances as will give rise to an implication of a promise or undertaking to make "just compensation" [citing case] *but that Congress has, by the jurisdictional act, which speaks only of legal claims, opened up the question of the fairness of what was done or of the adequacy of the consideration paid, and has authorized the court to determine, adjudicate, and render judgment accordingly* [emphasis added].

True, the opinion speaks, in the first of these excerpts, of "a moral claim." But this seems to me to be because the court automatically equates claims which cannot be vindicated under the jurisdictional act—because that act should not be read as authorizing an inquiry into fairness of consideration—as necessarily "moral" claims. That does not mean that, in the court's eyes, these claims would fail under the Fifth Amendment if full consent had been given. The latter part of the second excerpt clearly separates the issue of a Fifth Amendment "taking" from that of an inquiry into fairness—and requires that Congress authorize *both* aspects. "The facts must show *not only* that there has been a 'taking' or 'misappropriation' by the Government of land or property of the tribe under such circumstances as will give rise to an implication of a promise or undertaking to make 'just compensation' [citing case], *but that* Congress has, by the jurisdictional act, which speaks only of legal claims, opened up the question of the fairness of what was done or of the adequacy of the consideration paid, *and* has authorized the court to determine, adjudicate, and render judgment accordingly" [emphasis added]. A separate, special authorization in the jurisdictional act to go into the fairness of the compensation seems to be required. The court, in a word, thought it had the jurisdiction to decide whether there had been a "taking" but no jurisdiction to determine whether the compensation paid by the Government was "just."[3]

In the end, the best I can make of the 1942 opinion is that the terms of the jurisdictional act were so entangled in the court's mind with its ultimate determination adverse to the Indians on the Fifth Amendment claim that the Government should fail in its current defense of *res judicata*. The "jurisdictional" component seems to me to have been too large a factor in the 1942 holding to preclude the Nation from its right to show now that the acquisition of the Black Hills was a Fifth Amendment taking, without just and adequate compensation, rather than merely a violation of fair and honorable dealings. I am not persuaded that in 1942 the Indians had the opportunity to present their Fifth Amendment claim to a tribunal which deemed itself fully empowered to decide all aspects of that demand on their merits.[4]

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[3] The same theme seems to be reflected at the beginning of the opinion when the court says (97 Ct. Cl. at 657–58):

"If the lands or other property rights of plaintiff were misappropriated or taken by the United States in violation of the treaty of 1868, and contrary to the authority which Congress possessed under the treaty and the law governing the rights of the parties, *without the payment of compensation therefor and under such circumstances as to give rise to an implied contract to pay just compensation for the property taken contemporaneously with the misappropriation or taking,* plaintiff is entitled to recover. But if, under the circumstances disclosed by the record, Congress acted within the limits of its authority under the law and the treaty in acquiring the lands and hunting rights *for which it made compensation,* the plaintiff is not in our opinion entitled under the terms of the jurisdictional act to recover [emphasis added]."

Note that the court separates the case in which Congress pays no "compensation" from that in which it does pay some "compensation," without suggesting that the court can, under this jurisdictional act, decide whether the "compensation" paid was "just."

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518 F. 2d 556

# JAMES STRONG, ET AL. v. THE UNITED STATES

Appeal No. 1–74

Ind. Cl. Comm. Docket Nos. 13–G, 15–E, 27–B, 29–C, 64, 89, 120, 130, 18–M, 40–F, 252, 335 and 338

31 Ind. Cl. Comm. 89

[Decided June 25, 1975]*

ON APPEALS FROM THE INDIAN CLAIMS COMMISSION

**Indian claims; appeals from Indian Claims Commission; title to land; aboriginal title; recognized title; Treaties of Greeneville; Fort Stanwix, Harmer and Canandaigua.**—This case involves appeals from an interlocutory determination by the Indian Claims Commission of title claims by various tribal claimants to the area identified as Royce Area 11, as well as title claims to several smaller areas north and west of Royce Area 11, all of which were relinquished to the United States by the tribes who signed the 1795 Treaty of Greeneville, and by the Six Nations who signed the Treaties of 1784 at Fort Stanwix, of 1789 at Fort Harmer and of 1794 at Canandaigua. The Commission found that (a) except for two relatively small segments of land held aboriginally by the Delaware and Shawnee tribes, respectively, Royce Area 11 was not held by the ancestors of the present claimants in such a manner as to require defendant to compensate them under the Indian Claims Commission Act. The Commission also determined (b) that claimants had no compensable interest in most of the smaller areas involved in this claim, all located north and west of the Greeneville Treaty Line. It is *held* that (1) taking each tribe's right to title individually and utilizing the cited legal precedents, the Commission's denial of aboriginal title for the large portion of Royce Area 11 was correct; (2) after reviewing the evidence presented to the Commission, the applicable treaties cited by claimants do not show that any of their ancestors had recognized title to any part of Royce Area 11, and the Commission's denial of recognized title was therefore correct; (3) the Government's contentions that the Delaware and Shawnee abandoned their respective relatively small portions of Royce Area 11, are without merit and the finding of the Commission awarding title to these two tribes for the small portions of Royce Area 11 is supported by substantial evidence; and (4) that as to the Commission's determination (b) above, the Commission is correct with the exception of the Ouatanon enclave for which the findings are not sufficient to enable the court to decide the issue raised in the appeal by the Peoria Tribe, and this claim is remanded for additional proceedings. Since the amounts to be recovered by the several successful claimants were not determined in the interlocutory decision, the case is also remanded for further proceedings in that regard.

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[4] Since the court does not reach the question of whether, *res judicata* aside, the acquisition would be such a "taking" without just compensation, I do not reach or discuss that issue.

*On December 8, 1975 the petitions for certiorari of James Strong, et al. Pottawatomie Tribe, and Hannahville Indian Community were *denied*.

**Indian claims; land; title to land; Indian title land; generally.**

[1] The right of sovereignty over discovered land has always been subject to the right of use and occupancy and enjoyment of the land by Indians. This right of use and occupancy by Indians is known as "Indian title," "original title" or "aboriginal title." (*Sac & Fox Tribe* v. *United States*, 179 Ct. Cl. 8, 20–21, 383 F. 2d 991, 997, *cert. denied*, 389 U.S. 900 (1967)).

Indians 🔑 10

**Indian claims; land; title to land; Indian title land; proof of Indian title; generally.**

[2] To be accepted under the Indian Claims Commission Act, aboriginal title must rest on actual, exclusive and continuous use and occupancy for a long time prior to the loss of the property (*Sac & Fox Tribe* v. *United States*, 161 Ct. Cl. 189, 201–02, 315 F. 2d 896, 903, *cert. denied*, 375 U.S. 921 (1963)).

United States 🔑 105

**Indian claims; land; title to land; Indian title land; joint ownership or occupancy.**

[3] Although normally no tribe will be deemed to have proven aboriginal title when others used and occupied the land in question, two or more tribes or groups might inhabit an area in joint and amicable possession without erasing the exclusive nature of their use and occupancy. To qualify for treatment under joint and amicable occupancy, the relationship of the Indian groups must be extremely close.

Indians 🔑 10

**Indian claims; treaties with Indians; construction and operation; generally.**

[4] The Court of Claims in its appellate review jurisdiction is free to reach its own independent conclusion as to interpretation of treaties

between the United States and Indian tribes since interpretation of treaties is a question of law and not a matter of fact.

Courts 🔑 467

**Indian claims; land; title to land; recognized title; generally.**

[5] Where Congress has by treaty or statute conferred upon Indians or acknowledged to Indians the right to permanently occupy and use land, the Indians have a right or title to that land which is variously referred to as "treaty title," "reservation title," "recognized title" and "acknowledged title," and such right may be established in a variety of ways.

Indians 🔑 11

**Indian claims; land; title to land; recognized title; proof of recognition.**

[6] The significance of the "recognized title" doctrine generally lies in the fact that an Indian tribe, successful on this issue, need not present proof demonstrating aboriginal use and occupancy. However, the claimants must still prove that Congress intended to recognize that they had the right to permanently use and occupy the land area under scrutiny.

Indians 🔑 10

**Indian claims; land; boundaries; establishment of; Treaty of Greeneville.**

[7] Where uncertainty exists as to the extent to which the Indians alienated their lands under the Treaty of Greeneville, this court will rely upon subsequent relevant treaties to define the boundaries of the lands ceded to the United States by the treaty.

Indians 🔑 11

**Indian claims; land; title to land; joint ownership or occupancy.**

[8] The fact that certain tribes subsequently combined into a single entity does not show that they jointly owned land prior to that event to qualify for treatment under the joint and amicable occupancy theory.

Indians 🔑 10

**Indian claims; land; title to land; permissive use by another tribe.**

[9] Where, based on substantial evidence, the Indian Claims Commission found that the Wyandot had Indian title to a certain area and that settlement in the area by two bands of Ottawa was with the permission of the Wyandot, the Wyandot aboriginal title was not diminished by such permissive use nor did such use give the Ottawa an interest in the land as of the time of the 1795 Greeneville Treaty.

Indians 🔑 10

**Indian claims; treaties with Indians; construction and operation of treaties; Grouseland Treaty.**

[10] The Grouseland Treaty of 1805 is an acknowledgment by the parties to the treaty that the Miami, Eel River and Wea had been

an entity prior to 1805 and that they held the subject land in common.

**Indians ⚷ 11**

*James R. Fitzharris*, attorney of record, for James Strong, et al., as the representatives and on behalf of all members by blood of the Chippewa Tribe of Indians; for Robert Dominic, et al., on behalf of the Ottawa Tribe of Indians; for the Shawnee Tribe of Indians of Oklahoma, et al., appellants, cross-appellees.

*Robert C. Bell, Jr.*, attorney of record, for Hannahville Indian Community, et al., appellants, cross-appellees.

*Rodney J. Edwards*, attorney of record, for Red Lake Band, et al.; for Lawrence Zane, et al., ex rel. Wyandot Tribe, et al., appellants, cross-appellees.

*Robert S. Johnson*, attorney of record, for the Potawatomie Tribe of Indians, the Prairie Band of the Potawatomie Tribe of Indians, et al., appellants, cross-appellees.

*David L. Kiley*, attorney of record, for Ira Sylvester Godfroy, et al., ex rel. the Miami Indian Tribe, appellants, cross-appellees.

*Paul G. Reilly*, attorney of record, for the Six Nations, appellants, cross-appellees.

*Louis L. Rochmes*, attorney of record, for the Delaware Tribe of Indians; for the Absentee Delaware Tribe of Oklahoma; for the Citizen Band of Potawatomi Indians of Oklahoma, appellants, cross-appellees.

*Edwin A. Rothschild*, attorney of record, for the Miami Tribe of Oklahoma, appellants, cross-appellees.

*Jack Joseph*, attorney of record, for the Eastern Shawnee Tribe of Oklahoma, et al., for the Peoria Tribe of Indians of Oklahoma, et al., appellants, cross-appellees.

*Allan Hull*, attorney of record, for the Kickapoo Tribe of Oklahoma, the Kickapoo Tribe of Kansas, et al., and the Ottawa Tribe of Oklahoma, et al., appellants, cross-appellees.

*Robert E. Fraley*, with whom was *Assistant Attorney General Wallace H. Johnson*, for the United States, appellee, cross-appellant.

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Before COWEN, *Chief Judge*, KUNZIG and BENNETT, *Judges*.

COWEN, *Chief Judge*, delivered the opinion of the court:

This case is before the court on numerous appeals, as well as the Government's cross-appeal, from various portions of an interlocutory decision of the Indian Claims Commission dated August 9, 1973. The consolidated proceedings below involved the determination by the Commission of title claims by various tribal claimants to an area of land identified on Royce's Map of Ohio as Area 11 (hereinafter called Royce Area 11), as well as claims of title by several appellants to certain smaller areas and rights of passage located north and west of Royce Area 11. The land with which this appeal is concerned was relinquished to defendant by the various tribes who signed the Treaty of Greeneville of August 3, 1795 (7 Stat. 49),[1] and by the Six Nations[2] who signed the treaties of October 22, 1784 (7 Stat. 15), at Fort Stanwix; of January 9, 1789 (7 Stat. 33), at Fort Harmar; and of November 11, 1794 (7 Stat. 44) at Canandaigua.

In summary, the Commission found that, except for two relatively small segments of land held "aboriginally" by the Delaware and Shawnee Tribes respectively, Royce Area 11 was not held by the ancestors of the present Indian claimants in such a manner as to require defendant to compensate them under the Indian Claims Commission Act, 60 Stat. 1049. Furthermore, the Commission determined that the appellants had no compensable interest in most of the smaller areas lying north and west of Royce Area 11. For the reasons discussed below, we hold that, with one exception, the Commission's findings of fact are based on substantial evidence in the record and that its conclusions of law are correct.

## I

By far the largest area covered by the Commission's decision was Royce Area 11, consisting of approximately 18,000,000 acres and covering two-thirds of what is today the State of Ohio and a small contiguous area in Indiana.[3] It is, therefore, not surprising that the most vigorous and lengthy contentions of the parties deal with this territory.[4] Simply stated, the tribal appellants seek affirmance of the Commission's determinations that the Delaware and Shawnee Tribes had aboriginal title to certain portions of Royce Area 11, and reversal of the Commission's decision that in the remainder of Royce Area 11, there was no Indian title. On the other hand, the Government contends that no tribe is entitled to recover additional compensation for any portion of Royce Area 11, since none had aboriginal or recognized title. Defendant further argues that, if any title did exist at any point in time, it was extinguished. Thus, the Government seeks affirmance of the Commission's decision against claimants and a reversal of the decisions favorable to the Delaware and Shawnee in Royce Area 11, and to the Wyandot in Royce Area 20 and the unsurveyed area near Sandusky, Ohio.

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[1] The following tribes were signatories of the Treaty of Greeneville: Wyandots, Delawares, Shawnees, Ottawas, Chippewas, Potawatomis, Miamis, Eel-Rivers, Weas, Kickapoos, Piankeshaws, and Kashaskias. The treaty, by its terms, superseded various earlier agreements made with certain of the above tribes.

[2] The Six Nations was a confederacy consisting of the Seneca, Cayuga, Oneida, Onondaga, Mohawk, and Tuscarora Nations. In these treaties the Six Nations relinquished its claims of title to the areas west of New York, which included Royce Area 11

The Commission's opinion and accompanying findings of fact trace in detail the history of Indian settlements in this area from 1650 through 1795, emphasizing the evolving relationships among the various tribes and between the several tribal groups and the French, the British, and the Americans. The findings demonstrate considerable thoroughness and attention to detail, and for the most part they are not questioned by the Indian appellants. As stated in the Opening Brief of Certain Appellants: "The issues in these appeals [as to Royce Area 11] involve primarily questions of principle, not of fact."

*Aboriginal title.* The primary "question of principle" presented in the Indian claimants' appeals concerns the Commission's concept of "aboriginal title." Throughout its discussion of this issue, the Commission relied on past case law in determining whether claimants sufficiently proved the existence of aboriginal title at the cession date in 1795. The doctrine of aboriginal title is not new. As the court stated in *Sac & Fox Tribe* v. *United States*, 179 Ct. Cl. 8, 20–21, 383 F. 2d 991, 997, *cert. denied*, 389 U.S. 900 (1967):

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[3] Article III of the Treaty of Greeneville drew a general boundary line between land agreed to be owned by the United States and lands agreed to be owned by the Indian signatories of the treaty. This line, called the Greeneville Treaty Line, began at the mouth of the Cuyahoga River on Lake Erie at a point where Cleveland is now located. From this point, the Line ran south approximately 70 miles to Fort Lawrence, Ohio, then to the Indian border at Fort Recovery. The Line then proceeded southwest to a point on the Ohio River approximately 25 miles east of the Ohio State border. All lands south and east of this line, which were ceded and relinquished to the United States, were identified as Royce Area 11.

[4] We need not decide some of the issues presented by various appellants because these issues become important only if we uphold their claim of aboriginal title, which we do not.

> [T]he right of sovereignty over discovered land was always subject to the right of use and occupancy and enjoyment of the land by Indians. This right of use and occupancy by Indians came to be known as "Indian title." It is sometimes called "original title" or "aboriginal title."

Similarly, the requirements for an Indian claimant to prove aboriginal title have been listed on numerous occasions in the past. For example, we held in *Sac & Fox Tribe* v. *United States*, 161 Ct. Cl. 189, 201–02, 315 F. 2d 896, 903, *cert. denied*, 375 U.S. 921 (1963), that

> [t]o be accepted under the Indian Claims Commission Act, aboriginal title must rest on *actual, exclusive and continuous use and occupancy "for a long time" prior to the loss of the property.* [Emphasis supplied.]

*See United States* v. *Santa Fe R.R.*, 314 U.S. 339 (1941); *Confederated Tribes of Warm Springs Reservation* v. *United States*, 177 Ct. Cl. 184, 194 (1966), and cases cited therein. It was with this standard that the Commission approached its task in this case.

The obstacle facing the Indian claimants in this litigation is the requirement of "exclusiveness." Generally, mixed and non-exclusive use and occupancy of an area precludes the establishment of any aboriginal title by any of the users of the subject property. *Quapaw Tribe* v. *United States*, 128 Ct. Cl. 45, 120 F. Supp. 283 (1954). The purpose of this requirement is fairly obvious. In order to award compensation to the Indians for the value of land ceded to or taken by the Government, it is essential that the Commission first determine that the land in question was truly "owned" by the ancestors of the particular claimant or claimants. Certainly, one of the primary characteristics of ownership is the desire and ability to exclude others from the area over which ownership is claimed. Confronted with a similar issue recently, the court stated in *United States* v. *Pueblo of San Ildefonso*, 206 Ct. Cl. 649, 513 F. 2d 1383 (1975):

> Implicit in the concept of ownership of property is the right to exclude others. Generally speaking, a true owner of land exercises full dominion and control over it; a true owner possesses the right to expel intruders. In order for an Indian tribe to establish ownership of land by so-called Indian title, it must show that it used and occupied the land to the exclusion of other Indian groups. True ownership of land by a tribe is called in question where the historical record of the region indicates that it was inhabited, controlled or wandered over by many tribes or groups. [*Id.* at 669, 513 F. 2d at 1394]

"Exclusiveness" becomes a problem to plaintiffs simply because the historical record of Royce Area 11 demonstrates clearly that, with the exceptions found by the Commission, the area as a whole was "inhabited, controlled or wandered over by many tribes or groups." Indeed, claimants' own expert witnesses testified that prior to 1795 there was no exclusive use and occupancy ascertainable in the overall Royce Area 11 or in any large portion of it. Thus, without more, it would seem that the appeals grounded on claims of aboriginal title must be denied. Faced with the problem, the appellants have urged us to redefine the aboriginal title concept to fit their particular situations. According to the claimants:

> 'Aboriginal title' as of 1795, if it means anything, must refer either to the customs and practices of the Indians in the ceded area, at the relevant times, or to the 1795 law of the sovereign United States. The sharing of lands by tribes who had not otherwise combined in the ceded area to form a new entity, conformed to both.

This attempt to have us redefine a concept which has stood the test of many decisions in the past is not persuasive. We are not disposed to discard a principle which has, in numerous cases, been held to meet the purposes and objectives of the Indian Claims Commission Act.

However, a denial of claimants' attempt at redefining the "aboriginal title" theory does not automatically result in the defeat of their aboriginal title claim. Although normally no tribe will be deemed to have proven aboriginal title when others used and occupied the land in question, there is a "built-in exception" to the "exclusivity" requirement. Actually, this "exception" merely creates a method of analysis of "exclusivity" in certain rare situations. In the past, the court has held on several occasions that two or more tribes or groups might inhabit an area in "joint and amicable" possession without erasing the "exclusive" nature of their use and occupancy. *See United States* v. *Pueblo of San Ildefonso, supra; Turtle Mt. Band of Chippewa Indians* v. *United States*, 203 Ct. Cl. 426, 490 F. 2d 935 (1974); *Sac & Fox Tribe* v. *United States*, 179 Ct. Cl. 8, 383 F. 2d 991, *cert. denied*, 389 U.S. 900 (1967). To qualify for treatment under "joint and amicable" occupancy, the relationship of the Indian groups must be extremely close. We described just such a relationship in *Sac & Fox Tribe* v. *United States*, 179 Ct. Cl. at 16, 383 F.2d at 995, as follows:

> Originally the Sac and Fox Nation consisted of two separate and identifiable tribes of Indians belonging to the Algonquin stock. Around 1735, due to their mutual hostility and conflict with the French, they formed a close and intimate alliance, politically and socially, *so that from thence forward they have been dealt with and referred to as a single nation both in their relationship with other Indian tribes and in treaty negotiations and other matters with the United States.* (Emphasis supplied)

Indeed, the tribal relationship between the Sac and the Fox was deemed by the court to be so close as to constitute a "merger" of the previously existing tribal entities.

The Commission was correct in finding that no such relationship existed among the tribal claimants in the case presently before the court. The attempts by appellants to prove the existence of a "confederacy" of various tribal entities living at times in Royce Area 11 are simply not persuasive, when one reviews the evidence presented to the Commission. The cooperation upon which claimants rely can be explained readily without reference to any "confederacy" theory. In this regard it should be remembered that Royce Area 11 was, during the relevant time period, "an immense open territory which was sufficiently large to accommodate all those Indians who settled or hunted there." 31 Ind. Cl. Comm. at 111. Thus, one reason for cooperation among the tribal claimants was the lack of any need for inter-tribal warfare over the property rights of the various tribes. The area was simply too large and untamed for such activity to be necessary. Furthermore, the cooperation which did exist resulted from the existence of a common enemy, the "white man," who, according to the evidence, battled the tribes continuously. Finally, there is little evidence in the record to support a theory that the Indians considered themselves as "one nation." The 1750 inter-tribal council, relied on so heavily by the claimants, was not such a recognition; instead, it was an attempt to reduce the likelihood of armed conflict between various tribes interested in their own tribal interests. The United States did not view the tribal residents of Royce Area 11 as a confederacy. For example, the Commission, in looking at those lands on the Indian side of the Greeneville Treaty Line, found:

> * * * it was understood by the Government's representatives and the Indians [at Greeneville] that each tribe had separate lands, that there was no community of interest in the lands of the Northwest territory.

5 Ind. Cl. Comm. 180, 214 (1957). For these reasons, we reach the same conclusion that we reached in *Iowa Tribe* v. *United States*, 195 Ct. Cl. 365, 370 (1971), *cert. denied*, 404 U.S. 1017 (1972), where we held:

> The [tribes] did not consider themselves, and were not treated, as a single or closely integrated entity, but rather as separate political groups which were friends or allies (for the most part). Their use of the same lands may have been in common, like much of Indian use of the midwestern and western regions—but the Commission could properly decide that it was not proved to be truly joint, and therefore that each separate tribe's claim to Indian title would have to be tested on its own distinct basis.

Taking each tribe's right to title individually and utilizing the applicable precedents discussed above, it becomes obvious that the Commission's denial of aboriginal title for a large portion of Royce Area 11 was correct.

*Recognized title.* Several of the claimants in this case also argue that, even if aboriginal title is not found for Royce Area 11, their ancestors had "recognized title" to this land. According to their contentions, Indian title to this land was recognized by the Government (1) by its assumption of the rights and obligations of the British Crown under the Fort Stanwix Treaty of 1768; (2) by its own treaties of 1775, 1776, and 1778, and (3) by its acknowledgments of Indian title during the post-Revolutionary War era. We recognize at the outset that "we are free to reach our own independent conclusion on this question since the interpretation of a treaty is a question of law and not a matter of fact." *Citizen Band of Potawatomi Indians* v. *United States*, 179 Ct. Cl. 473, 482, 391 F. 2d 614, 618 (1967), *cert. denied*, 389 U.S. 1046 (1968); *see Minnesota Chippewa Tribe* v. *United States*, 161 Ct. Cl. 258, 262, 315 F. 2d 906, 908 (1963). After making that independent determination, we have concluded that the Commission's denial of recognized title in this case was correct.[5]

The doctrine of recognized title, like that of aboriginal title, is not novel, and there can today be little room for misunderstanding precisely what proof must be presented by claimants seeking to benefit from it. These standards were clearly summarized in *Miami Tribe* v. *United States*, 146 Ct. Cl. 421, 439, 175 F. Supp. 926, 936 (1959) as follows:

> Where Congress has by treaty or statute conferred upon the Indians or acknowledged in the Indians the right to *permanently* occupy and use land, then the Indians have a right or title to that land which has been variously referred to in court decisions as "treaty title," "reservation title," "recognized title," and "acknowledged title." As noted by the Commission, there exists no one particular form for such Congressional recognition or acknowledgment of a tribe's right to occupy permanently land and that right may be established in a variety of ways. [citing *Tee-Hit-Ton* v. *United States*, 348 U.S. 272 (1955); *Hynes* v. *Grimes Packing Co.*, 337 U.S. 86 (1949); *Minnesota* v. *Hitchcock*, 185 U.S. 373 (1902).]

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[5] Claims listed in the Opening Brief of Certain Appellants as "moral and equitable claims" are merely a repetition of plaintiffs' aboriginal title claims and are likewise without merit. *See Otoe & Missouria Tribe of Indians* v. *United States*, 131 Ct. Cl. 593, 131 F. Supp. 265, *cert. denied*, 350 U.S. 848 (1955).

The significance of the recognized title doctrine generally lies in the fact that a plaintiff successful on this issue need not present proof demonstrating aboriginal use and occupancy. *Id.* at 445, 175 F. Supp. at 940. The theory has special interest to the claimants in this case, since it was their failure to prove "exclusive use" which resulted in their defeat on the aboriginal title claims discussed above.

Although the claimants need not demonstrate "exclusive use" to show possession of recognized title, they must still prove that Congress intended to recognize that they had the right to permanently use and occupy the land area under scrutiny. This requirement has long been a part of the recognized title doctrine as enunciated by the Commission and the courts. As we stated in *Sac & Fox Tribe* v. *United States*, 161 Ct. Cl. 189, 197, 315 F. 2d 896, 900, *cert. denied*, 375 U.S. 921 (1963):

> Appellants apparently assume that "recognition" or "acknowledgment" necessarily follow from an acceptance by the United States of the bare fact that the particular Indians dwelt or hunted, or claimed to dwell or hunt, in the area at that time. But there must be another indispensable element before recognition is had. *The Congress must affirmatively intend to grant the right to occupy and use the land permanently.* (Emphasis supplied.)

Taking a close look at each treaty, we have determined that the claimants have failed to show the necessary Congressional intention to grant them "permanent" rights in Royce Area 11. They have failed to demonstrate that the "recognition" involved here was anything more than "permissive occupation." *See Sioux Tribe* v. *United States*, 205 Ct. Cl. 148, 500 F. 2d 458 (1974). The 1768 Fort Stanwix Treaty, upon which the Chippewa, Shawnee and Wyandot rely, was negotiated by the British to protect against a threatened Indian uprising. Furthermore, this treaty was entered into by the Six Nations of New York. It is very questionable what role, if any, was played by the Ohio tribes at this conference, since their representation was quite small and their "rank and file" never accepted the boundary drawn up by the agreement. The meetings in Pittsburgh during 1775 and 1776 occurred because of the Government's desire to maintain a semblance of Indian neutrality during the Revolutionary War; these informal gatherings cannot be viewed as Government recognition of Indian title. The Treaty of September 17, 1778, relied on by the Delaware claimants, was clearly a treaty of peace entered into by the Government to counter British propaganda that the Americans planned to confiscate Indian lands. At most, the guarantee of Delaware "territorial rights" as described in Article VI of the 1778 treaty can be read as a declaration of American intention to continue the former British policy of respecting Indian title where it was established against third parties.

By the end of the American Revolution, the intent of the United States Government was "unequivocally the opposite of what is required to establish recognized title." 31 Ind. Cl. Comm. at 107. Through the post-Revolutionary War era until 1795, the Government attempted through its military might and its skills at the negotiating table to rid Royce Area 11 of the appellants. The first treaty negotiated after the close of the War was the Treaty of Fort Stanwix of October 22, 1784, in which the Government attempted to convince the tribal representatives of the Six Nations that Indian title had been relinquished by their ally, Great Britain, in the Treaty of Paris of 1783. This so-called "right of conquest" theory is evidence of the Government's intention not to acknowledge Indian title, but to make peace with formerly hostile Indians and at the same time to obtain clear rights to lands northwest of the Ohio River. This doctrine was also used in various talks with the Wyandot, Delaware, Ottawa, Chippewa, and Shawnee during 1785–1786 but proved, in the end, to be unsuccessful in maintaining peace in Royce Area 11. Instead, augmented by British agents, the Indian hostility remained. Toward the end of 1787, in response to pleas for another treaty, a Congressional committee recommended to the Congress that the "policy of conquest" be replaced by a policy in which the Government would negotiate and "purchase" the Indian lands in question. Congress then authorized Governor St. Clair of the Northwest Territory to negotiate with the dissident tribes, instructing him as follows:

> The primary objects of the treaty are, the removing [of] all causes of controversy, so that peace and harmony

> continue between the United States, and the Indian tribes, the regulating [of] trade, and settling boundaries * * * *

This change in policy does not demonstrate, as claimed by several of the appellants, that the Government had determined to recognize Indian title to this area. To the contrary, the Government's instructions to its representative demonstrate that its motives were otherwise. Furthermore, the Government's activities in encouraging settlement in this region pursuant to the Ordinance of May 20, 1785, does not show an intention to recognize Indian title. Thus, we have concluded, after reviewing the evidence presented to the Commission, that the treaties and policies cited by appellants do not show that any of them had "recognized title" to any part of Royce Area 11.

*The Government's Cross-Appeal as to Royce Area 11.* We also affirm the Commission's finding of aboriginal title for the Delaware and Shawnee Tribes in the two relatively small portions of Royce Area 11. In describing the area of land awarded to the Delaware Tribe, the Commission stated:

> Delaware presence in [the upper Muskingum and its tributaries] during [1742 to 1781] was overwhelmingly predominant and lasted a long time. Those incidents of use and occupancy by other Indians we view as permissive or as so sporadic as not to be inconsistent with Delaware use and occupancy * * * * Based upon the evidence in this record, we conclude that as of the date of the 1795 Treaty of Greeneville, the Delaware Indians possessed aboriginal title to that portion of Royce Area 11 included within the present-day counties of Tuscarawas, Coshockton and Muskingum in Ohio.

31 Ind. Cl. Comm. at 121. With regard to the Shawnee award tract, the Commission found that:

> The Shawnees continuously used and occupied this area from the late 1730's until they were forced to abandon these lands in the late 1770's * * * * Until they were forced out in the late 1770's, the Shawnees had established Indian title to the area bounded on the north by an east-west line running along the 40th degree north latitude and on the south by a straight line running from the city of Athens in Athens County west to the town of Highland in northern Highland County, and bounded on the east and west by the lines described in note 6 of

> the findings of fact as the east and west boundaries of central Royce Area 11.

31 Ind. Cl. Comm. at 122–23. Defendant appeals from this portion of the Commission's opinion, claiming that (1) the Commission's findings of fact do not support its ultimate determinations that aboriginal title existed for these portions of Area 11; (2) the Delaware and the Shawnee had abandoned their respective lands prior to 1789, and (3) the "prior sovereigns" of Virginia, Connecticut and the "Colonial Confederacy" extinguished Indian title to this land.

The thrust of defendant's first argument is that the Commission failed to use the correct standard of proof for determining aboriginal title. We acknowledge that the findings are not as clear and concise as they might have been. However, after much study, we have decided that the findings themselves are supported by substantial evidence. It is clear that the Commission, after finding that the two tribes in question enjoyed "predominance" over certain portions of Royce Area 11, restricted the determination of aboriginal title to that limited area of land over which the tribes in question enjoyed exclusive occupancy and control. We are not presented here with a situation in which we are unable to ascertain precisely what method the Commission utilized to arrive at its final decision. *Cf. Seminole Indians* v. *United States*, 197 Ct. Cl. 350, 455 F. 2d 539 (1972). Indeed, it would be unreasonable to conclude that the Commission would use a standard of proof other than the one with which it is so familiar, which it found so readily in the case law, and which it set forth so accurately in its opinion. Therefore, defendant's contentions concerning abandonment and extinguishment of title to these tracts of land are without merit and deserve no extended discussion in this opinion.

## II

Having resolved the claims relating to Royce Area 11, we now turn to the remaining appeals. In the 1795 Greeneville Treaty, the Indians not only ceded Royce Area 11, but also relinquished their claims to 16 enclaves (described in Article III), five rights of passage (described in Article III), and four other areas (described in Article IV)—all of which were located north and west of the Greeneville Treaty Line. In the proceedings before the Commission, the Indian claimants sought to establish aboriginal title to these areas. In some instances they were successful; in others they were not. On appeal, we are primarily concerned with the areas in which the Commission found that the appellants had no aboriginal title. The Government's cross-appeal is limited to the Commission's determination in favor of the Wyandot.

The Commission found insufficient evidence of Indian title with respect to Royce Areas 12, 13, 14, and 15 in Ohio, Detroit and the surrounding area, the areas located at the Straits of Mackinac (Royce Areas 21, 22, and 23 in Michigan), Royce Area 25 (known as Clark's Grant), Royce Area 26 (the Vincennes Tract), and the lands traversed by three of the rights of passage. Several Indian groups have appealed from the Commission's determination as to these areas. In addition, the Ottawa Tribe claims it is entitled to participate in the Wyandot recovery for an area around Fort Sandusky in Ohio. The Peoria Tribe of Oklahoma (representing the Weas) asserts that the Commission erred in denying recovery for the Ouatanon enclave and that the Peoria Tribe is entitled to participate in the recoveries of the Miami Tribe. For the reasons given below, we reject the claims of the appellants, as well as the Government's cross-appeal, and affirm the Commission's determination as to all areas with the exception of the Ouatanon enclave. The findings of the Commission as to this enclave are not sufficient to enable us to decide the issue raised in the appeal by the Peoria Tribe.

*The Vincennes Tract* (*Royce Area 26, Indiana*). The Vincennes Tract, ceded to the United States in the 1795 Greeneville Treaty, was defined in Article IV of the Treaty as follows: "[t]he post of St. Vincennes on the river Wabash, and the lands adjacent, of which Indian title has been extinguished." The question before us is whether the appellants possessed aboriginal title to any part of what is known as the Vincennes Tract (Royce Area 26) at the time of the Greeneville Treaty.

The Commission found that the boundaries of the Vincennes Tract ceded at Greeneville were described in the 1803 Fort Wayne Treaty (7 Stat. 74) and that in the 1803 Treaty, the Indians acknowledged that any claims they may have had to this area were extinguished prior to 1795. The Commission further found that no Indian tribes possessed aboriginal title to the Vincennes Tract at the time of the 1795 Greeneville Treaty.

The Peoria/Piankeshaw and the Delaware Tribes appeal from this determination. They contend that the two tribes between them had aboriginal title to the area around St. Vincennes until 1803 (except as to that portion of the land which had been given to the French prior to the Greeneville Treaty). They also claim that the Indians ceded only an area of 180,000 acres at Greeneville and that in the 1803 Fort Wayne Treaty, the United States defined the ceded area around St. Vincennes in such a way that the tract was increased from the original cession of 180,000 acres to an area of 1.8 million acres. From this, they argue that the 1803 Treaty provided no additional consideration to the Indians for the increase in the amount of the ceded land, and that the Indian parties to the treaties are entitled to recover under the Indian Claims Commission Act for an unconscionable taking of property amounting to the difference between the 1.8 million acres and the 180,000 acres originally ceded in 1795. We hold that the Commission's determination is supported by substantial evidence and is correct as a matter of law. Therefore, we reject appellants' arguments to the contrary.

The Greeneville Treaty did not specifically delineate the boundaries of the Vincennes Tract; rather the treaty makes only a vague reference to lands in which title had previously been extinguished. The record shows that the Indians had given the French an area of land surrounding St. Vincennes in about 1742, but the size of the grant was not clearly defined. *See*, L. Lux, *Vincennes Donation Lands* 428–29 (1949); Carter, *Territorial Papers of the United States*, Vol. II 58–59 (1934). Nor were the boundaries of the French grant subsequently clarified under the periods of British and American control prior to 1795. While the United States did institute a land grant system in 1788 under which it is estimated that the United States eventually distributed about 180,000 acres in the Vincennes area (*see*, L. Lux, *supra*, at

444–46, 478, 481), there is no indication that these grants bore any relationship to the total amount of land which the Indians had given the French and which were subsequently ceded to the United States at Greeneville. Thus, there was apparently no definite understanding at the time of the Greeneville Treaty concerning what lands had previously been alienated by the Indians.

It was only after the Greeneville Treaty that the Governor of the Indiana Territory, William Henry Harrison, undertook to define the boundaries of the Vincennes Tract. Because of the uncertainty, even at that time, as to the extent to which the Indians had alienated the land around Vincennes prior to Greeneville, Harrison began negotiations with the Indians in the Vincennes area with a view toward establishing the boundaries by agreement. These negotiations culminated in the 1803 Fort Wayne Treaty, by which the parties agreed to the cession of approximately 1.8 million acres.[6] The 1803 Treaty is the first time that the boundaries of these lands were clearly defined, and there is no indication that the 1803 Treaty increased the size of the Vincennes Tract, as appellants argue. The 1803 Treaty was intended to define the scope of the earlier cession, not to change it. Under these circumstances, we do not find the absence of additional consideration a factor[7] which entitles appellants to recover.

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[6] The First Article of the Fort Wayne Treaty of June 7, 1803, provided:

"Whereas it is declared by the fourth article of the treaty of Greeneville, that the United States reserve for their use the post of St. Vincennes and all the lands adjacent to which the Indian titles had been extinguished: *And whereas,* it has been found difficult to determine the precise limits of the said tract as held by the French and British governments: it is hereby agreed, that the boundaries of the said tract shall be as follows: Beginning at Point Coupee on the Wabash, and running thence by a line north seventy-eight degrees, west twelve miles, thence by a line parallel to the general course of the Wabash, until it shall be intersected by a line at right angles to the same, passing through the mouth of White river, thence by the last mentioned line across the Wabash and towards the Ohio, seventy-two miles, thence by a line north twelve degrees west, until it shall be intersected by a line at right angles to the same, passing through Point Coupee, and by the last mentioned line to the place of beginning." 7 Stat. 75.

[7] Before the Commission, the appellants claimed that they had aboriginal title in 1795 to part of Royce Area 26. In order to recover, they had to show not only that they used this area prior to 1795, but also that the entire area had not been alienated prior to 1795. In the proceedings before the Commission, the appellants had an opportunity to put in evidence on both points or to respond to the Government's evidence concerning the Indian alienation of the land in the Vincennes area prior to 1795. Under the circumstances, we do not think the Commission erred in relying upon the 1803 Treaty to establish the

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In other cases, we have relied upon subsequent treaties to define the boundaries of lands covered by the Treaty of Greeneville (*see Miami Tribe* v. *United States*, 146 Ct. Cl. 421, 442, 175 F. Supp. 926, 938 (1959)). We follow the same practice in this instance where the question is one of defining the boundaries of the land ceded to the United States at Greeneville.

At Greeneville, the Indians ceded the lands surrounding St. Vincennes to which title had previously been extinguished. This area was defined in the 1803 Treaty as the entire area now included in Royce Area 26. Consequently, appellants' attempt to prove aboriginal title to this area or any part of it in 1795 by evidence of use and occupancy was not successful.

Even if it is conceded that the Delawares and the Piankeshaws had used a part of the Vincennes Tract prior to Greeneville, as appellants argue, such shared use, without more, would not constitute the exclusive use and occupancy required to establish aboriginal title.

*Clark's Grant* (*Royce Area 25, Indiana*). Clark's Grant is a tract of 150,000 acres of land located in southern Indiana which was ceded to the United States for the use of George Rogers Clark and his men by Article IV of the Greeneville Treaty.[8] The appellants[9] claim that the Commission erred in finding they had no aboriginal title to this area. They argue (1) that, since this area contains only 150,000 acres, proof of specific village locations within the area should not be required to establish Indian ownership; (2) that appellants' showing of use and occupancy of the adjoining areas should be sufficient to cover this area, and (3) that the findings of the Commission on this issue are self conflicting.

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extent of pre-Greeneville alienation. Nor is it appropriate to remand the case to enable the appellants to put in evidence to show that the pre-Greeneville alienation was smaller than the estimated 180,000 acres distributed by the United States.

[8] Subsection 1, Article IV, of the 1795 Greeneville Treaty provided:

"The tract of one hundred and fifty thousand acres near the rapids of the river Ohio, which has been assigned to General Clark, for the use of himself and his warriors [shall be excepted from the general relinquishment of claims by the United States to land north and west of the Greeneville Treaty Line]". 7 Stat. 51.

[9] The appellants on this claim are the Peoria (Piankeshaw/Wea) plaintiffs in Docket 338, the Delaware plaintiffs in Dockets 27-B and 338, and the Miami plaintiffs in Docket 252.

While the Commission found that the appellants had title to several different pieces of land adjacent to Royce Area 25 (*see* 31 Ind. Cl. Comm. 89, 131), there is a lack of evidence showing exclusive use and occupancy of Royce Area 25 by any one tribe or a united group of tribes. Appellants have based their claim upon the shared use of this land by the neighboring tribes, and they ask for a recovery to be divided among the several tribes. As previously stated, the mere fact that two or more different tribes shared the use of the land is insufficient to establish joint Indian title to the property. Since the appellants have not made the requisite showing of exclusive use and occupancy, we find that the Commission's determination is supported by substantial evidence.

There is no "logical contradiction" in the Commission's finding that the United States "perfected its title" to Clark's Grant in the Greeneville Treaty and its finding that none of the appellants had title to this tract. At Greeneville, the Indians jointly acknowledged the earlier grant to Clark and the United States confirmed its title to this land.[10] Appellants failed to show either an aboriginal or a recognized title interest in this land. The fact that they collectively granted it to Clark and subsequently acknowledged the grant in the Greeneville Treaty, does not give them a compensable interest in the land.

*Royce Areas 12, 13, 14, 15, and the Rights of Passage.* Royce Areas, 12, 13, 14, and 15 are separate tracts (or enclaves), located north and west of the Greeneville Treaty line, which were ceded to the United States at Greeneville.[11]

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[10] The original grant to Clark was made long before the Greeneville Treaty. On June 16, 1779, after Clark captured Vincennes from the British, Clark received a "deed of gift" to what is now known as Clark's Grant. The "deed of gift" was signed by the Piankeshaw chief, Francis son of Tobacco, who made the gift in the names of "all the Great Chiefs and Warriors of Ouabash and their allies." At that time, Clark was a Colonel in the Virginia militia, and he accepted the lands as a possible site for a fort.

In 1784, Virginia ceded its claims to this tract along with its claims to other tracts northwest of the Ohio River to the States of the Confederation. The United States held this title until the Indians ceded their rights to Clark's Grant in 1795.

[11] Royce Areas 12 through 15 are described in Article III of the Greeneville Treaty as follows: *Royce Area 12:* "One piece of land six miles square at or near Loromie's store;" *Royce Area 13:* "One piece two miles square at the head of the navigable water or landing on the St. Mary's river, near Girty's town;" *Royce Area 14:* "One piece six miles square at the head of the navigable water of the Au-Glaize river;" *Royce Area 15:* "One piece six miles square at the confluence of the Au-Glaize and Miami rivers, where Fort Defiance now stands." 7 Stat. 50.

As to these areas, the Commission found that none of the Indian claimants had aboriginal title in 1795. The Commission also found that Royce Areas 12, 13, and 14 were located so close to the Greeneville Treaty Line that they should be treated as appendages of the nearby portions of Royce Area 11. Moreover, the Commission found that the sporadic use of Royce Area 15 by various groups did not support a finding of aboriginal title in any tribe.

Several Indian tribes are appealing from this decision.[12] These appellants all argue, at least in part, that these areas should be treated the same as Royce Area 11 and that the various Indian tribes shared the use of the land, thus acquiring a common compensable interest or a "joint aboriginal title." We rejected this argument in our discussion of the Vincennes Tract, Clark's Grant, and Royce Area 11, and we need not discuss it further. The fact that Royce Area 14 is adjacent to Royce Areas 165 and 166, which were granted to the Shawnee by Article 6 of the Treaty of September 29, 1817, (7 Stat. 162), and that Royce Area 14 was relatively close to Shawnee settlements in Royce Area 11 in the late 1770's and early 1780's, does not establish exclusive use and occupancy by the Shawnee of Royce Area 14. Since there is little or no evidence of exclusive use and occupancy by any tribe or unified combination thereof in any of these areas, we hold that the Commission's determination is supported by substantial evidence.

Article III of the Greeneville Treaty also granted the United States free passage over certain routes on the Indian side of the Greeneville Treaty Line. These rights of passage were not cessions, but they nevertheless constituted a grant of valuable property rights. Only three of the rights of passage are in issue on appeal—those designated by the Commission as routes 1, 2, and 3. As to these, the Commission found that appellants had no aboriginal title interest.[13] Here again, the appellants[14] argue that they have a compensable interest by virtue of their shared usage of the land traversed by the rights of passage. We cannot accept this position for the reasons previously stated in the discussion of the claims to Royce Area 11. Accordingly, the decision of the Commission on this issue is affirmed.

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[12] The Miami Tribe in Docket 252 has filed an appeal with respect to Areas 12 and 13; the Shawnee in Dockets 335 and 338 has appealed with respect to Royce Areas 12, 13, and 14; the Ottawa plaintiffs in Docket 338 appeal the determination in Areas 13, 14, and 15; the Wyandot in Docket 120 and the Shawnee in Docket 64 join in appealing the determination as to Areas 12, 13, 14 and 15; and the Chippewa plaintiffs in Docket 13-G appeal the determination with respect to Area 15.

*Royce Areas 21, 22, and 23.* These areas consist of land on Mackinac Island and the northern tip of lower Michigan at the Straits (Royce Area 21), the southern tip of the upper Michigan peninsula (Royce Area 22), and the Island of Bois Blank located a few miles from the Straits (Royce Area 23). The appellants[15] contend that the Commission erred in finding that they had no aboriginal title to these areas; again, they argue that their shared use of the land made them joint owners of the land. This contention is rejected on the same grounds which we have discussed in denying similar claims.

The Ottawa and Chippewa appellants make the further argument that they should be treated as joint owners of these lands in the same way as was done with Royce Area 205, which is adjacent to the lands in issue here (*see* 7 Ind. Cl. Comm. 576). The Ottawa and Chippewa parties in this appeal were the plaintiffs in that case, where the Commission found that the Ottawa and Chippewa Tribe had aboriginal title to Royce Area 205, primarily because they found that the Ottawa and Chippewa had formed a single entity sometime after 1795 and before 1836. The appellants here have not shown evidence of such unity prior to 1975. The fact that these tribes combined into a single entity after 1795 does not show that they jointly owned the land prior to that date. The Commission found that in 1795 Royce Areas 21, 22, and 23 were areas of common use and occupancy by autonomous bands of the Ottawa and Chippewa Indians and that they failed to establish aboriginal title. We find this determination is supported by substantial evidence.

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[13] The rights of passage described in the last paragraph of Article III of the Greeneville Treaty are nearly all over the waters of navigable rivers. The portions that traverse land are (1) that portion of the first passage running from Loromie's store (Royce Area 12, Ohio) to the St. Mary's River (the portage path meets the St. Mary's River within Royce Area 13, Ohio); (2) that portion of the second passage running from Loromie's store (Royce Area 12, Ohio) to the Au-Glaize River at a point within Royce Area 14—this passage includes the portage between Royce Areas 12 and 13 and then proceeds through Royce Area 87 for a distance of approximately nine miles to Royce Area 14; and (3) that portion of the third described passage running from Loromie's store (Royce Area 12) to the Sandusky River (this passage most probably proceeded across south-central Royce Area 87 for a distance of approximately 60 miles). *See* 31 Ind. Cl. Comm. 89, 202–03.

[14] The Wyandot plaintiffs in Docket 120, the Shawnee in Docket 64, the Chippewa in Docket 13–G, and the Shawnee and Peoria in Dockets 335 and 338, and the Ottawa plaintiffs in Docket 338 all appeal the Commission's determination with respect to the rights of passage.

[15] The appellants in this instance are the plaintiffs in Dockets 18–M and 40–F (Ottawa and Chippewa), as well as the Potawatomie Tribe, plaintiffs in Docket 15–E.

*Detroit and Surrounding Area.* This area consists of approximately 288,000 acres around Detroit. In this appeal, the Wyandot Tribe argues that the Commission erred in finding that no tribe possessed aboriginal title to the area surrounding Detroit in 1795. The Ottawa Tribe and the Prairie Band of the Potawatomie Indians also appeal from the Commission's decision on the ground that they shared the use of this area with other tribes and thus acquired a joint interest in the land, for which they are entitled to compensation.

The main issue is whether the Wyandot Tribe established aboriginal title to the land. The evidence shows that Cadillac founded a post at Detroit in 1701. From 1710 to 1720, four tribes had settlements around Detroit: Chippewa, Potawatomi, Ottawa, and Wyandot (Huron). While the Chippewa never established a strong presence in the area, the other tribes shared the use of these lands for about half of the Eighteenth Century. The Ottawas occupied a village near Detroit until 1763, when they moved south into the Maumee River area of Ohio; the Potawatomis occupied a village in the ceded area from 1710 to approximately 1764 when they left the area; and the Wyandots maintained a settlement in the area from 1705 to 1742 when they moved across the Detroit River into present-day Ontario. The period of mixed occupancy up to approximately 1763 shows that no tribe or unified tribal combination had the requisite exclusive use and occupancy to establish aboriginal title up to that time.

The Wyandot claim is based primarily on the fact that in 1777 they established two village sites at present Wyandotte and Gibraltar, Michigan, within the ceded area, and that they remained there until 1796. The Commission found that no other Indian groups were in the area during these years. The Wyandot conclude that this is sufficient proof of exclusive use and occupancy to establish Indian title in 1795. The Wyandot position does not account for the fact that whites had moved into the Detroit area in relatively large numbers prior to the Greeneville Treaty. The Commission found that shortly after Cadillac's settlement of Detroit, whites were granted lands adjacent the Fort.

Later, several tracts of land were sold or granted by Indians to settlers. By 1788, there were approximately 4,000 whites settled on both sides of the Detroit River. The area for several miles around the post of Detroit was farmland. The Commission found that by 1795 most of the Detroit area was occupied by whites.

In this instance, we are not presented with a question of whether the white intrusion on Indian land extinguished a previously established aboriginal title. *Turtle Mountain Band* v. *United States*, 203 Ct. Cl. 426, 447–48, 490 F. 2d 935, 947 (1974). Nor is the white settlement on the land being used to establish a date for the extinguishment of Indian title. *United States* v. *Pueblo of San Ildefonso*, *supra*, 206 Ct. Cl. at 663–64, 513 F. 2d at 1391–92; *United States* v. *Northern Paiute Nation*, 203 Ct. Cl. 468, 474–75, 490 F. 2d 954, 958 (1974). Here, the Wyandot Tribe did not have aboriginal title at the time of white settlement, which began in the early Eighteenth Century and increased thereafter. The presence of white settlers in the area shows that the Wyandot Tribe did not exclusively use and occupy the entire Detroit area prior to 1795. On the basis of the evidence in the record, we conclude that the Commission's determination of this factual issue is supported by substantial evidence.

It is not necessary to discuss the claims of the Ottawa and the Prairie Band of the Potawatomi which are also based on the shared use theory. This argument has been treated in our discussion of Royce Area 11, and, again, we rely on the reasons given there in rejecting this claim.

*Ouatanon or the Old Wea Towns.* This area, ceded in Article III of the Greeneville Treaty, was described as "[o]ne piece six miles square at the Ouatanon or old Weea towns on the Wabash river." While the Commission found that this area was located within the aboriginal area of the Wea Nation in 1795, which at that time was a part of the Miami Tribe, the Commission also found that the area was subsequently returned to the Indians by the Treaty of September 30, 1809 (7 Stat. 113); that it was receded to the United States as part of Royce Areas 98 and 99 by the Wea and Miami Tribes in the Treaties of October 2, 1818 (7 Stat. 186) and October 6, 1818 (7 Stat. 189); that the Wea had been compensated for most of the land as part of Royce Area 99, and that a small portion of the ceded land north of the Wabash River is included within the claim of the Peoria Tribe in another docket (Docket 314–A) before the Commission. Consequently, the Commission determined that the Indians were not entitled to recover for this enclave.

Appellant[16] takes issue with this conclusion for several reasons, one of which is that the evidence before the Commission is insufficient to show that the Weas were compensated for this land, even in part, through the recovery for Royce Area 99. After reviewing the briefs, treaties, cited cases, and after oral argument, we find that the Commission's determination on this issue is too summary for us to decide whether the Commission's findings are supported by substantial evidence or whether the conclusions of law are valid and supported by the findings of fact.

Article 8 of the Treaty of September 30, 1809, provided that "[t]he United States agree to relinquish their right to the reservation, at the old Ouroctenon towns, made by the treaty of Greenville, so far at least as to make no further use of it than for the establishment of a military post." (7 Stat. 114). It is significant that the Weas were not a party to this treaty, although they subsequently gave their consent (7 Stat. 116). Also, it is unclear which tribes received the rights to this area and what rights were received. Furthermore, the record does not show whether the Ouatanon enclave was included in the 1818 cessions by the Weas or the Miamis. We therefore conclude that the Commission has not furnished a sufficient statement of the reasons for its findings and conclusions under 25 U.S.C. § 70r(3) for us to review the Commission's decision on this issue. (*See Sac & Fox Tribe* v. *United States*, 196 Ct. Cl. 548 (1971); *United States* v. *Nez Perce Tribe*, 194 Ct. Cl. 490, 503, *cert. denied*, 404 U.S. 872 (1971)), and we remand this portion of the case for further proceedings.

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[16] The appellant in this instance is the Peoria Tribe of Indians of Oklahoma in Docket 338, representing the Wea.

*The Area Around Fort Sandusky and Royce Area 20.* Article III of the Greeneville Treaty ceded to the United States the following area around Fort Sandusky: "[o]ne piece six miles square upon Sandusky lake, where a fort formerly stood." The Treaty describes Royce Area 20 as "[o]ne piece two miles square at the lower rapids of the Sandusky river." These areas are located in northern Ohio on or near Lake Erie. The Commission found that the Wyandot had Indian title to these areas because of their use of the Fort Sandusky area from 1737 to 1748 and from the early 1750's until after 1795 and on the basis that the Wyandots had exclusive use and occupancy of the land in Royce Area 20 from 1760 to 1794. The Commission further found that two bands of Ottawas settled in the Fort Sandusky area from 1784 to 1811 but that the use and occupancy by the Ottawas was with the permission of the Wyandots.

The Ottawa appellants take issue with the decision to the extent that it does not allow them to participate in the recovery for the Fort Sandusky area. They argue that the Commission found the Ottawas had two settlements in this area prior to 1795, that there is no evidence upon which to conclude that this use was by permission of the Wyandot, and that even if their use was by permission of the Wyandot, they have a compensable interest by virtue of their shared use of the property. We hold that there is substantial evidence to support the Commission's decision on this point. The Wyandot had been in the area around Sandusky for more than 30 years prior to the Ottawa settlements. There is evidence that the Wyandot had given permission to other Indian tribes to use their lands in Ohio, and we think the record, taken as a whole, supports the inference that the Ottawa were in the Sandusky area with the consent of the Wyandot. Permissive use by the Ottawa did not diminish the title of the Wyandot, and by the same token, such use gave the Ottawa no interest in the land. *The Spokane Tribe of Indians* v. *United States*, 163 Ct. Cl. 58, 68 (1963).

The Government also appeals from the Commission decision concerning the area around Fort Sandusky and from the determination as to Royce Area 20, claiming that Indian title to these enclaves had been extinguished by prior sovereigns before March 3, 1789, with the result that the Wyandot did not have aboriginal title at the time of the Greeneville Treaty. The Government takes the position that Virginia, Connecticut, or the Colonial Confederacy extinguished Indian title to these enclaves as well as to certain areas within Royce Area 11. The Commission found that the inclusion of the Fort Sandusky area within Connecticut's Western Reserve had no effect on the aboriginal title of the Wyandot to this area, which was ceded to the United States in 1795. We have considered the Government's arguments on prior extinguishment and conclude, as did the Commission, that the Wyandot held aboriginal title to these enclaves at the time of the Greeneville Treaty.

*Wea Participation in Miami Recoveries.* The Wea are currently one of the constituent tribes of the Peoria appellants in Docket 338. Before the Commission, the Wea claimed that they were entitled to a one-third interest in any Miami recoveries resulting from the Greeneville Treaty by virtue of the fact that the Miami, Eel River, and Wea had formerly been one nation and were a nation at the time of the 1795 Greeneville Treaty. The Commission did not go so far as to find what interest, if any, the Weas would have in any Miami recoveries, but the Commission did find that the Weas were part of the Miami Tribe in 1795.

The Miami appellant takes issue with the Commission's finding to the extent that it would allow the Weas to share in Miami recoveries. With the exception of Royce Areas 16 and 17, and a portion of the fifth described passage in Article III of the Greeneville Treaty, we have found that the Miami did not have a compensable interest in any of the lands ceded to the United States at Greeneville. Consequently, the question of Wea participation in Miami recoveries only concerns the recovery, if any, for two of the enclaves and one right of passage in which the Commission found the Miami held aboriginal title in 1795.

The appellant claims that the Weas had no interest in the disputed property because the Weas did not occupy or control any of these lands or have a recognized title interest. Appellant argues further that the statement in the Grouseland Treaty that the Miami, Eel River, and Wea were "one nation" prior to 1805 did not constitute a retroactive determination that each tribe owned an undivided interest in the property of the other 10 years before the Grouseland Treaty. Finally, appellant argues that such intertribal relations were political rather than land-owning.

The evidence shows that the Miami, Eel River and Wea considered themselves as an entity and that they agreed to hold their property in common. Article IV of the Grouseland Treaty, signed August 21, 1805, provided:

> As the tribes which are now called the Miamis, Eel River and Weas, were formerly and still consider themselves as one nation, and as they have determined that neither of these tribes shall dispose of any part of the country which they hold in common; in order to quiet their minds on that head, the United States do hereby engage to consider them as joint owners of all the country on the Wabash and its waters, above the Vincennes tract, and which has not been ceded to the United States, by this or any former treaty; * * * (7 Stat. 91–92)

The Grouseland Treaty is an acknowledgment by the parties to the treaty that the Miami, Eel River, and Wea had formerly been an entity prior to 1805 and that they held their property in common. This was the basis for considering them to be joint owners of the property in 1805. In a letter to the Secretary of War, dated March 22, 1814, William Henry Harrison stated:

> The Miamies have their principal settlements at the forks of the Wabash, thirty miles from fort Wayne; and at Mississineway, thirty miles lower down. A band of them under the name of weas [sic], have resided on the Wabash sixty miles above Vincennes; and another under the Turtle on Eel river, a branch of the Wabash, twenty miles northwest of fort Wayne. By an artifice of the Little Turtle these three bands were passed on general Wayne as distinct tribes, and an annuity was granted to each. The Eel river and Weas however to this day call themselves Miamies, and are recognized as such by the Mississineway band.

The Commission has on two previous occasions found the Weas to have been a constituent part of the Miami Nation in the period prior to 1795 (*see* 2 Ind. Cl. Comm. 617, 618; 5 Ind. Cl. Comm. 180, 181) and these decisions were affirmed in pertinent part in 146 Ct. Cl. 421 (1959). This evidence supports the Commission's determination that the Wea were part of the Miami Tribe in the Eighteenth Century and as such they are entitled to participate in the Miami recoveries.

As for the division of interests, the Commission did not specify the percentage of recovery which should be given to the Wea, and neither party asks us to make such a determination. Accordingly, the allocation of interests is to be decided by the Commission on remand.

### III

In conclusion, we hold, with one exception, that the Commission has correctly resolved the numerous issues involving Royce Area 11 and the smaller areas north and west of the Greeneville Treaty Line. Accordingly, we affirm the Commission's determinations in these matters. As previously stated, that portion of the Commission's decision dealing with the Ouatanon enclave is remanded to the Commission for additional proceedings in accordance with this opinion. Since the amount to be recovered by the several appellants was not involved in the Commission's interlocutory decision, we also remand the case for further proceedings in that regard.

*REMANDED*

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## GEORGE Z. STEUER v. THE UNITED STATES

[No. 174-72. Decided June 25, 1975]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Military pay; appointment and commission procured by fraud; equitable estoppel; laches.**—Plaintiff, who was born in Czechoslovakia, came to this country in January 1953 and in November 1955 he acquired American citizenship. In October 1954 he applied for a Reserve commission in the United States Army Medical Corps, his application stating that he had a B.S. degree in pathology from the University of Prague (1948), an M.D. degree with a major in surgery from the University of Zurich (1952), and that he had been a resident physician in pathology at a Denver, Colorado, hospital. He also submitted what he represented to be a certified translation of his diploma purportedly received from the University of Zurich. On March 25, 1955 plaintiff was commissioned a first lieutenant in the Army Reserve, and on April 3, 1955 he was ordered to active duty in the Army Medical Corps. While on duty in Germany, plaintiff applied for a Regular Army commission, again representing that he was a graduate of the University of Zurich, and in July 1960 he was tendered and accepted a Regular commission and was promoted to captain in the Army Medical Corps. In January 1963 he was promoted to major. In 1965 his scholastic background was investigated and it was found and plaintiff admitted that he had not graduated from the University of Zurich Medical School, that he had not been granted a degree of doctor of medicine, and that the alleged diploma did not originate with said university. In February 1966 plaintiff submitted his "unqualified resignation", indicating his desire to return to the Army following completion of qualifying studies. Because of the unique nature of this matter a legal opinion was requested and obtained from the Judge Advocate General who determined that plaintiff's commission was void from its inception, that he had no legal status from which to resign, and that it would be legally objectionable to accept his resignation. Plaintiff was released on April 29, 1966 by Special Order. Plaintiff appealed his release to the Board for Correction of Military Records on April 5, 1967 and on June 15, 1967 his appeal was denied. He filed his petition in this court on April 27, 1972, seeking pay and allowances and reinstatement, alleging that he was improperly removed in violation of statute and regulations relating to dismissal of officers and that he was unconstitutionally denied due process. It is *held* that plaintiff's claim of procedural violation is without merit. Since plaintiff was not validly commissioned under 10 U.S.C. § 3294, his reliance on 10 U.S.C. § 1161 setting forth limitations on dismissal of commissioned officers is misplaced and inappropriate. It is also *held* that plaintiff's claim is barred by laches, the court commenting that it has had few, if any, cases of greater unjustified delay in bringing suit. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Fraud; fraud against the United States.**

[1] Fraud perpetrated against the United States is not excused by the fact that the military was negligent in not verifying for several years after plaintiff was commissioned and served in the Army Medical Corps as a doctor his allegations that he had certain foreign medical degrees satisfying the statutory requirements.

Fraud 🔑 22(1)

**Estoppel; equitable estoppel; detrimental reliance by party invoking.**

[2] The doctrine of equitable estoppel prevents a party from profiting by his own fabrications and misconduct when the other party has detrimentally relied upon them.

Estoppel ⚷ 52.15

**Military pay; courts-martial jurisdiction; discharge; appointment procured by fraud.**

[3] Where plaintiff procured his appointment and commission in the Army Medical Corps through fraud and by misrepresenting that he was a medical doctor, it was not procedural violation to unilaterally deny him a court-martial pursuant to 10 U.S.C. § 1161 since he was not validly commissioned under 10 U.S.C. § 3294 and the fraud achieved no status of validity by the fact that it was successfully concealed for a long time.

Armed Services ⚷ 11

**Statutes; construction and operation; absurdity.**

[4] Statutes, like regulations, must not be construed to produce absurd and whimsical results unrelated to congressional purpose.

Statutes ⚷ 212.3

**Laches; generally.**

[5] Laches is a doctrine grounded on considerations of public policy that for the peace of society demands diligence in the prosecution of erroneous dismissal and removal actions in order to avoid stale claims. Delay in searching for a lawyer or pursuit of permissive administrative remedies does not excuse excessive or unreasonable delay.

Equity ⚷ 75

**Military pay; laches; suit for back pay.**

[6] While the court is reluctant to impose the bar of laches in such a way as to discourage reasonably prompt, good faith pursuit of permissive administrative remedies for relief, where almost 5 years elapsed between the adverse decision by the military correction board and plaintiff's suit filed in this court just 2 days short of the 6-year statute of limitations, the unverified assertion of indigency and lack of credit as excuses for the procrastination is not a plausible defense to the bar of laches in a suit for back pay.

Armed Services ⚷ 13.6(1)

**Military pay; laches; prejudice; necessity for showing.**

[7] Unjustified, unreasonable delay alone is insufficient to support laches in military pay cases, unless prejudice to defendant arising from the delay is shown, as for instance where the Government is handicapped in defense in a trial on the merits by the routine destruction of records and the scattering and loss of potential witnesses, or prejudice in not having received the services which plaintiff claims he was eligible to render and for which he claims he

**should have been paid following his separation, since there is a presumption that another had to do plaintiff's work and be paid for it.**

**Armed Services ⚿ 13.6(1)**

**Laches; prejudice; burden of proof.**

**[8] When the delay in bringing suit for back pay has been of such long duration that the burden of overcoming the possibility of prejudice to defendant has shifted to plaintiff to show that defendant is not prejudiced, and where plaintiff has not met that burden, his claim must fall before the concept that "equity aids the vigilant, not those who slumber on their rights."**

**Armed Services ⚿ 13.6(2)**

*Robert H. Reiter*, attorney of record, for plaintiff. *Spaulding, Reiter & Rose*, of counsel.

*Francis H. Clabaugh*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before SKELTON, KASHIWA and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

This case is before the court on cross-motions for summary judgment as a matter of law. The essential facts are not disputed. The action is for recovery of pay and allowances and for reinstatement of plaintiff who alleges that he was improperly removed from his position as a major in the United States Army Medical Corps in violation of statute and regulations relating to dismissal of officers and that he has unconstitutionally been deprived of all due process. For reasons which follow we conclude that plaintiff is not entitled to recover.

Plaintiff, who became a naturalized American citizen on November 29, 1955, was born in Prague, Czechoslovakia, and came to the United States on January 10, 1953, under provisions of the Displaced Persons Act, ch. 647, 62 Stat. 1009 (1948), as amended. The Selective Service classified him as 1-A. He had been a conscientious objector but then applied for a Reserve commission in the United States Army Medical Corps on October 19, 1954. He had studied medicine at the University of Prague and at the University of Zurich, Switzerland. On his application he stated that he had attended high school in Warsaw, Poland, and that he had a B.A. degree (1947) and a B.S. degree in pathology from the University of Prague (1948), and an M.D. degree with a major in surgery from the University of Zurich (1952). He stated, also, that he had been an instructor in pathology at the University of Prague in 1947 and that he had been an intern in surgery and a resident physician in pathology at a hospital in Denver, Colorado, from July 1953 to October 1954. Before his internship he listed research work as having been done at the Colorado University School of Medicine in Denver. In further support of his application for a commission he submitted what he represented to be a certified translation of his diploma purportedly received from the University of Zurich on December 12, 1952, signed by the dean of the medical school and by the dean of the medical faculty.

Pursuant to his application and representations, plaintiff was tendered—and on March 24, 1955, accepted—an appointment and was commissioned as a first lieutenant in the Army Reserve, service number O4023322. Plaintiff was ordered to active duty effective April 3, 1955, and required to report to the medical field service school, Fort Sam Houston, Texas.

On May 5, 1959, while on duty at the Army hospital in Munich, Germany, plaintiff applied for a Regular Army commission. In support thereof he again represented that he was a graduate of the University of Zurich but this time listed his major as pathology rather than surgery. His application was endorsed by his commander and deputy commander who praised plaintiff's performance of duties and professional qualifications. Plaintiff was tendered a Regular commission on July 6, 1960, which he accepted on July 19, 1960. He was then promoted to the rank of captain in the Army Medical Corps and on January 5, 1963, was promoted to the rank of major.

The Surgeon General of the Army in 1965 gave the American Medical Association (AMA) a list of names of Regular officers, including plaintiff's, as eligible for AMA membership and requested that plaintiff's name be placed on the AMA master list of physicians. The AMA routinely sought to verify plaintiff's medical education by writing to the University of Zurich Medical School which came back with the advice that plaintiff had not graduated there and had not been granted the degree of doctor of medicine, as plaintiff had represented. The AMA advised plaintiff of this by letter and denied him AMA membership. A copy of the letter went to the Surgeon General.

This startling development led the Army to make inquiry of its own of the University of Zurich and this confirmed the AMA information. Plaintiff had failed certain essential examinations, failed to take others, was denied a diploma and certification as a medical doctor, and on July 16, 1952, was refused further admission to the medical school. The text of the forged diploma plaintiff had submitted to defendant to obtain his commission was not even the same as actually used by the university on its valid diplomas.

There followed a formal criminal investigation by the military police on five alleged offenses: fraud; false official statement; using a false document; fraudulent appointment; and wrongfully, willfully, and unlawfully practicing medicine without being duly licensed or qualified. The Criminal Investigation Detachment (CID) report is before the court as an exhibit. It confirms the alleged offenses. On his behalf plaintiff told the CID investigators that the Army had never required him to produce a medical degree. However, plaintiff admitted that he did not complete his studies at the University of Zurich, was not granted a degree as a doctor of medicine by that university, and that the document on which he obtained his Medical Corps commission did not originate with the University of Zurich. The CID report states, in part:

> While in the state of being emotionally carried away with his past accomplishments, STEUER blurted out "that it wasn't fair that a couple of little lies on his service records should be held against him after all the money he saved the government because of his professional services."

The investigations further reported that a letter in plaintiff's file stated that he had not obtained a medical license from the State of Colorado. Plaintiff finally refused to answer further questions put to him by the investigators and sought refuge under Article 31 of the Uniform Code of Military Justice and refused to effect a written statement. Article 31 prohibits compulsory self-incrimination.

On January 16, 1966, plaintiff was arrested by Swiss police at Zurich for a forergy offense. However, he was deported on January 19, 1966, by Swiss authorities as an undesirable alien.

By letter of February 17, 1966, addressed to the Adjutant General, Washington, D.C., plaintiff submitted what he described therein as his "unqualified resignation" specifying it "to be effective at the earliest possible date." He stated that the reason for resignation was because of questions raised about his formal educational qualifications and that he desired to commence additional formal studies to rectify such, after which he wished to return to the Army or to enter civilian practice as a pathologist. He stated, further, that he expected a discharge under honorable conditions, and that he desired to be separated overseas. Plaintic was in Germany at the time where he was laboratory services chief and chief pathologist at the Army hospital in Munich.

Because this was a unique matter, the Judge Advocate General was asked for an opinion. That opinion, rendered on April 18, 1966, held that plaintiff's status as a commissioned officer "was void from its inception. As such, there is no legal basis for his continued service in the Army Medical Corps, and he should be removed therefrom without delay. * * * As Major Steuer has no legal status to resign from, it would be legally objectionable to accept the resignation tendered by him." It was suggeseted that the Comptroller General should be asked to rule on whether plaintiff had any right to retain any of the pay and allowances he had received. As a result of this opinion by the JAG, plaintiff was released from military service on April 29, 1966, by Special Order No. 90, by direction of the President of the United States. The order stated that the release was "due to his commission having been void from inception." There was also unelaborated reference to plaintiff's "unqualified resignation." Plaintiff did not receive a discharge certificate.

One year later, on April 5, 1967, plaintiff appealed to the Board for Correction of Military Records (hereinafter the Correction Board). On June 15, 1967, the board, without a hearing, denied plaintiff's appeal, stating that plaintiff had submitted insufficient evidence to indicate any probable material error or injustice. Plaintiff's petition was filed with this court on April 27, 1972, 5 years from his application to the board, and 2 days short of 6 years since plaintiff's release from the Army by the President's order. Plaintiff's motion for summary judgment was filed on March 14, 1974.

## I

Plaintiff's motion is stated by him to be based upon the fifth amendment to the Constitution which protects persons from deprivation of life, liberty, or property, without due process of law, and upon statute, 10 U.S.C. § 1161, which reads in part:

> § 1161. *Commissioned officers: limitations on dismissal.*
>
> (a) No commissioned officer may be dismissed from any armed force except—
> (1) by sentence of a general court-martial;
> (2) in commutation of a sentence of a general court-martial; or
> (3) in time of war, by order of the President.

Plaintiff also calls our attention to Article 83 of the Uniform Code of Military Justice, 10 U.S.C. § 883:

> § 883. *Art. 83. Fraudulent enlistment, appointment, or separation.*
>
> Any person who—
> (1) procures his own enlistment or appointment in the armed forces by knowingly false representation or deliberate concealment as to his qualifications for that enlistment or appointment and receives pay or allowances thereunder; or
> (2) * * *
> shall be punished as a court-martial may direct.

Upon the foregoing authority plaintiff says that he was entitled to a court-martial, that it was unilaterally denied, and that this is a procedural error which entitles him to back pay and reinstatement. He says that the pertinent statute and regulation foreclose any other method of separating him from the service and that violation thereof has deprived him of due process of law under the fifth amendment, notwithstanding implicit admission of fraud by his invocation of Article 83, *supra.* Particularly, plaintiff complains that not having been accorded a court-martial hearing, at which with assistance of counsel he could defend himself after notice and charges, was a denial of due process; deprived him of valuable property rights earned over a period of more than 11 years of satisfactory service; blotted his reputation; and imposed upon him and his family the "cruel punishment" of being stranded in a foreign country without even being paid for his last month of military service or without having been afforded travel expenses back to the United States as provided by USAREUR Reg. 635–10.

## II

Defendant's cross-motion for summary judgment is advanced on several grounds. *First*, defendant contends that plaintiff has not stated a claim for which relief can be granted as it involves the internal workings of the Army. *Second*, it is alleged that plaintiff has failed to show arbitrary or capricious action on the part of the Correction Board. *Third*, plaintiff's commission is said to be void because it was procured by fraud, which is apparent from plaintiff's misrepresentations that he was a medical doctor. *Fourth*, plaintiff was not a de facto officer because he did not act in good faith and defendant's acquiescence in his employment was induced by plaintiff's fraud. *Fifth*, defendant says that Article 83 and the statute were not violated because they pertain to commissioned officers and plaintiff's commission was void *ab initio* on account of plaintiff's fraudulent misrepresentations. *Sixth*, plaintiff voluntarily resigned and asked to be separated in Europe where he has chosen to remain. *Seventh*, plaintiff is barred by laches. All of defendant's arguments have merit but we do not reach them all because it is unnecessary. Plaintiff is not entitled to recover and his claim is clearly without merit. We rely upon two grounds for this conclusion.

## III

It is provided in 10 U.S.C. § 3294, in pertinent part as follows:

> § 3294. *Commissioned officers; Medical and Dental Corps: original appointment*
>
> (a) *Original appointments* in the Regular Army may be made in the grades of first lieutenant through colonel

> *in the Medical Corps* or Dental Corps, as the needs of the Army require. *These appointments may be made only from qualified doctors of medicine*, osteopathy, or dentistry, as the case may be, who are citizens of the United States *and who have such other qualifications as the Secretary of the Army may prescribe.* * * *. [Emphasis supplied.]

Defendant has cited an Army regulation, unchallenged by plaintiff, as follows:

> *Laws and regulations:*
>
> Paragraphs 13*a* and *b*, SR 140–105–6, 28 Jan. 1953:
>
> 13. Medical Corps.—Applicants for appointment and assignment to the Medical Corps branch must meet the following requirements:
>
> *a. Be currently licensed to practice medicine* in a State, Territory, or the District of Columbia, or possess a diploma from the National Board of Medical Examiners. *Be currently engaged in the ethical practice of medicine.* Waiver of license and actual engagement in practice may be granted for—
>
> (1) Graduates of approved medical schools
>
> (2) Individuals who have successfully completed the prescribed course of medical instruction at medical schools which are acceptable to the Department of the Army.
>
> *b. Possess the degree of Doctor of Medicine from a medical school* acceptable to the Department of the Army. * * *. [Emphasis supplied.]

It is not necessary to belabor the point that the undisputed evidence is that plaintiff was not a qualified doctor of medicine such as described by statute, that he was not licensed to practice nor ethically engaged therein, that he was not a graduate of a medical school and had no medical degree, and that he had not completed the necessary courses and examinations. His misrepresentations about his qualifications misled defendant. Of course, the negligence of defendant in failing for 11 years to make any effort to verify plaintiff's self-serving claims about his qualifications is appalling and cannot be condoned. But, this does not excuse the fraud. As soon as defendant was put on notice that there was a problem here it acted with dispatch to correct it. Plaintiff says defendant acted with too much dispatch, and that is the basis of his claim. But, there is a short answer which makes it unnecessary to reach the constitutional and other issues advanced by the parties. The answer is the doctrine of equitable estoppel which is properly invoked to prevent a party from profiting by his own fabrications and misconduct.

In *Weir* v. *United States*, 200 Ct. Cl. 501, 474 F. 2d 617, *cert. denied*, 414 U.S. 1066 (1973), the court considered the case of a former soldier who by sworn statements obtained a premature release from the military service by confessing to homosexual tendencies. Defendant verified the tendencies by a psychiatric investigation and evaluation. After he found that his military record prejudiced his civilian job opportunities, however, Weir claimed that he was not a homosexual, defendant should have found out that he had lied, and should have denied his discharge! On this he sued for back pay, restoration to his position, missed promotions, and for correction of his military records to show an honorable discharge. The court said in part:

> It has long been a standing principle in this court that the conduct and admissions of a party operate against him in the nature of an estoppel when the other party detrimentally relies upon that conduct or those admissions. *Mahoning Investment Co.* v. *United States*, 78 Ct. Cl. 231, 246, 3 F. Supp. 622, 629 (1933), *cert. denied*, 291 U.S. 675 (1934). In the *Mahoning* case it was clearly stated that
>
>> [T]he vital principle is that he who by his language or conduct leads another to do what he would not otherwise have done, shall not subject such person to loss or injury by disappointing the expectations upon which he acted. Such a change of position is *sternly forbidden*. It involves fraud and falsehood, and the law abhors both. [Emphasis in text. 200 Ct. Cl. at 510–11, 474 F. 2d at 622.]

The court in *Weir* described plaintiff's claim as "the outstanding example of *chutzpah* to the nth degree." 200 Ct. Cl. at 508, 474 F. 2d at 620. The instant case is a worthy rival.

Plaintiff's reply brief agrees that equitable estoppel is a valid doctrine and cites in support of it *Greve* v. *Gibraltar Enterprises, Inc.*, 85 F. Supp. 410 (D.N.M. 1949), *Glus* v. *Brooklyn E. Dist. Terminal*, 359 U.S. 231, 232–33 (1959), and *Fansteel Metallurgical Corp.* v. *United States*, 145 Ct. Cl. 496, 501, 172 F. Supp. 268, 271 (1959). But, plaintiff would invoke the doctrine against defendant for "contributing to the difficulties which in turn have led to the delay in filing" this suit. Just what fault of the Army has contributed to this delay is not specified. The argument is frivolous. Further reference to plaintiff's delay in prosecuting his claim is made in part IV of this opinion.

Plaintiff's claim that there has been a procedural violation because a statute or regulation was violated and that this entitles him to recover notwithstanding his own fraudulent misconduct, has no merit. Defendant did not acquiesce in plaintiff's military service knowing of his fraud. The fraud achieved no status of validity by the fact that it was successfully concealed for so long. Since plaintiff was really a civilian—he had been improperly commissioned and defendant did not ratify the commission or waive the mistake, not knowing of the fraud—there is even serious question as to whether plaintiff could be court-martialed especially if criminal sanctions were imposed upon him. *McElroy* v. *United States ex rel. Guagliardo*, 361 U.S. 281 (1960); *Reid* v. *Covert*, 354 U.S. 1 (1957); *United States ex rel. Toth* v. *Quarles*, 350 U.S. 11 (1955). However, since plaintiff was not validly commissioned under 10 U.S.C. § 3294, his reliance on 10 U.S.C. § 1161 is misplaced. It does not apply to him. Be that as it may, what would a court-martial really have accomplished in these circumstances where the fraud is so plain and is only sought to be excused as "a couple of little lies" that ought to be overlooked in view of plaintiff's long service? Plaintiff admits his fraud by reliance on Article 83, Uniform Code of Military Justice, *supra*. That regulation must be given a commonsense interpretation. *Weir* v. *United States*, *supra*, 200 Ct. Cl. at 509, 474 F. 2d at 621. Form must not be elevated above substance. A plaintiff bears a heavy responsibility for failure to receive a timely hearing on a charge when he did not raise it while in defendant's employment, and does not explain why he did not raise it. If there is any procedural error by defendant in such circumstances, it is harmless error. Further, where it is not shown that a regulation has been violated before leaving employment it is also harmless error. Here, plaintiff resigned voluntarily and sought no hearing and does not plead ignorance of his alleged right thereto. *Gratehouse* v. *United States*, 206 Ct. Cl. 288, 512 F. 2d 1104 (1975). Statutes, like regulations, must not be construed to produce absurd and whimsical results unrelated to congressional purpose. Plaintiff's argument, if adopted here, would produce such results. This is to be avoided. *Church of the Holy Trinity* v. *United States*, 143 U.S. 457, 460 (1892); *Kantor* v. *United States*, 205 Ct. Cl. 1 (1974); *Northwest Marine Iron Works* v. *United States*, 203 Ct. Cl. 629, 493 F. 2d 652 (1974).

## IV

Plaintiff's claim is also barred by laches, an affirmative defense pleaded by defendant. As noted above in the statement of facts, plaintiff was dismissed from the Army on April 29, 1966. His claim accrued on that date. *Cochran* v. *United States*, 205 Ct. Cl. 876 (1974); *Vincin* v. *United States*, 199 Ct. Cl. 762, 468 F. 2d 930 (1972); *O'Callahan* v. *United States*, 196 Ct. Cl. 556, 451 F. 2d 1390 (1971); *Crowe* v. *United States*, 196 Ct. Cl. 565, 452 F. 2d 1034 (1971); *Mathis* v. *United States*, 183 Ct. Cl. 145, 391 F. 2d 938 (1968). He applied to the Correction Board for relief on April 5, 1967, but lost his case there on June 15, 1967. His petition was not filed with the court until April 27, 1972, only 2 days short of the expiration of the 6-year statute of limitations within which time suit could be filed. 28 U.S.C. § 2501. There is no doubt that sufficient delay exists to bar the claim for laches, if it is not excusable delay, or unless defendant is not prejudiced by it. Plaintiff seeks to excuse his being so dilatory by alleging that he sought legal counsel unsuccessfully in 1966 and, being unable to afford his fees and living abroad in straitened circumstances, could not proceed.

Laches is a doctrine grounded on considerations of public policy that for the peace of society demands diligence in the prosecution of erroneous dismissal and removal actions in order to avoid stale claims. *Powell* v. *Zuckert*, 366 F. 2d 634, 636 (D.C. Cir. 1966); *Brundage* v. *United States*, 205 Ct. Cl. 502, 504 F. 2d 1382 (1974), *cert. denied*, June 2, 1975. Delay in searching for a lawyer does not excuse excessive delay. *Gersten* v. *United States*, 176 Ct. Cl. 633, 636, 364 F. 2d 850, 852 (1966). Pursuit of permissive administrative remedies does not excuse unreasonable delay. *Vincin* v. *United States, supra; Crowe* v. *United States, supra; Mathis* v. *United States, supra; Jackson* v. *United States*, 179 Ct. Cl. 29, *cert. denied*, 389 U.S. 985 (1967); *Gersten* v. *United States, supra*, 176 Ct. Cl. at 635–36, 364 F. 2d at 851–52; *Kirk* v. *United States*, 164 Ct. Cl. 738 (1964); *Alpert* v. *United States*, 161 Ct. Cl. 810, 823 (1963). Correction Board relief is generally a permissive administrative remedy and is so in the circumstances of this case. *Friedman* v. *United States*, 159 Ct. Cl. 1, 310 F. 2d 381 (1962); *cert denied*, 373 U.S. 932 (1963); *Lipp* v. *United States*, 157 Ct. Cl. 197, 301 F. 2d 674 (1962), *cert. denied*, 373 U.S. 932 (1963). *See generally* J. Glosser and K. Rosenberg, *Military Correction Boards: Administrative Process and Review by the United States Court of Claims*, 23 AM. U. L. REV. 391 (1973). We would be most reluctant to impose the bar of laches in such a way as to discourage reasonably prompt, good faith pursuit of permissive administrative remedies for relief. *Cason* v. *United States*, 200 Ct. Cl. 424, 432, 471 F. 2d 1225, 1229–30 (1973). But, that is not the situation here. Almost 5 years elapsed between the adverse decision by the Correction Board and plaintiff's filing suit in court. There is no explanation for this procrastination unless it is plaintiff's claim of indigency and lack of credit, substantiated only by the unsworn certification by his counsel in plaintiff's brief in response to defendant's motion. That could be a plausible defense against laches in some circumstances but not in a suit for back pay or where delay is unreasonably long. *Powell* v. *Zuckert, supra.* In *Brundage* v. *United States, supra*, the bar of laches was imposed by the court for the lapse of much less time than here when extenuating circumstances for the delay also were not shown. The court in that opinion reiterated the rule that unjustified, unreasonable delay alone is insufficient to support laches unless prejudice to defendant arising from that delay is shown. But, the court said:

> * * * It is reasonable to presume that another officer or officers have held plaintiff's position since he left the service, discharging the duties formerly performed by him, and drawing the salary plaintiff claims should have been paid to him. *See Blackmar* v. *United States*, 354

> F. 2d 340, 347, 173 Ct. Cl. 1035, 1046 (1965); *Bovard*, *supra*, 160 Ct. Cl. at 622. However, even if no one was selected to replace plaintiff, or to perform the tasks that once were his, a recovery by plaintiff would require the Government to pay him the salary of a Major for a period of over five and a half years [footnote omitted], during which time * * * he had ample opportunity to fully assert his claim. [205 Ct. Cl. at 510, 504 F. 2d at 1386–87.]

*Cf. United States ex rel. Arant* v. *Lane*, 249 U.S. 367, 372 (1919); *Chappelle* v. *United States*, 168 Ct. Cl. 362, 366 (1964). In *Brundage*, *supra*, the court made a presumption of prejudice based on a record that made such prejudice evident by unjustified, unreasonable delay in bringing suit. Defendant says that is the same situation we have before us again in the present case. Here, however, recovery, if allowed, would go back even longer, to 1966. Defendant assures the court that it is prejudiced by the routine destruction of some records and the scattering and loss of potential witnesses which would handicap its defense in a trial on the merits. Defendant also claims prejudice by not having received the services which plaintiff claims he was eligible to render and for which he claims he should have been paid since his separation from the Army. Someone else has had to do plaintiff's work and be paid for it, or at least that is so if we apply the presumption made in *Brundage*.

It is difficult to perceive a case where laches could more properly be asserted by defendant, or applied by the court, than here. We have had few, if any, cases of greater unjustified delay in bringing suit. The Supreme Court and lower courts have approved laches as a bar for shorter periods of time. To cite only a few of many examples: *Norris* v. *United States*, 257 U.S. 77 (1921); *Nicholas* v. *United States*, 257 U.S. 71 (1921); *United States ex rel. Arant* v. *Lane*, *supra; Powell* v. *Zuckert*, *supra*, 366 F. 2d at 636 n. 1; *Brundage* v. *United States*, *supra; Bovard* v. *United States*, 160 Ct. Cl. 619, *cert. denied*, 374 U.S. 830 (1963).

Laches has not often been applied by this court to bar military pay claims, but we have sufficient precedent for doing so, as we do here where the delay is unjustified and unreasonable, and the Government is obviously prejudiced by it in fact or by reasonable presumption. When the delay in bringing suit has been of such long duration that the burden of overcoming the possibility of prejudice to defendant has shifted to plaintiff to show that defendant is not prejudiced, and where plaintiff has not met that burden, his claim must fall before the concept that "equity aids the vigilant, not those who slumber on their rights." Quoted from 2 POMEROY's EQUITY JURISPRUDENCE § 418 (5th ed. 1941) in *Powell* v. *Zuckert*, *supra*, 366 F. 2d at 636. *See Wilmot* v. *United States*, 205 Ct. Cl. 666 (1974); *Bender* v. *United States*, 201 Ct. Cl. 865, *cert. denied*, 414 U.S. 1022 (1973); *Cason* v. *United States*, *supra*, 200 Ct. Cl. at 431, 471 F. 2d at 1229; *Grisham* v. *United States*, 183 Ct. Cl. 657, 392 F. 2d 980, *cert. denied*, 393 U.S. 843 (1968); *Gersten* v. *United States*, *supra*, 176 Ct. Cl. at 636, 364 F. 2d at 852.

Plaintiff's motion for summary judgment is denied. Defendant's cross-motion for summary judgment is granted. The petition is dismissed.

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**518 F. 2d 574**

## URBANIZADORA SANTA CLARA, S.A. v. THE UNITED STATES

**[No. 270-74. Decided June 25, 1975. Plaintiff's motion for rehearing *en banc* and for rehearing denied October 3, 1975.]**

ON DEFENDANT'S MOTION TO DISMISS OR FOR SUMMARY JUDGMENT AND PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

**Contracts; lease; release; claim for just compensation.**—Plaintiff, a Spanish corporation and owner of a housing project in Seville, Spain, leased the premises to the United States. The lease, which expired September 26, 1968, provided for stated monthly rental payments and contained no renewal provision. After the parties' unsuccessful attempts to execute a follow-on lease, the United States held over in possession of the premises after expiration of the lease, continuing to pay the same monthly rent until May 25, 1970 when it vacated the premises. Thereafter a series of settlement agreements were negotiated. By Modification No. 5 executed July 31, 1973 the parties agreed to a settlement of "all remaining claims" under the contract and plaintiff accepted a lump sum payment and dismissed with prejudice its appeal before the Armed Services Board of Contract Appeals. The modification set forth that plaintiff "does hereby fully release, discharge and settle any and all claims and disputes of every kind whatsoever, known and unknown, under this contract which the contractor [plaintiff] may have against the Government." On July 30, 1974 plaintiff filed suit seeking just compensation under the Fifth Amendment for the holdover period of the difference between the preexisting monthly rental payments and a higher rate which the parties negotiated for the unexecuted follow-on lease. Defendant contends, *inter alia*, that the claim is barred by the release of Modification No. 5. Plaintiff contends that the release may have released claims "under the contract" but the instant claim is not one under the contract and arose after the contract expired. It is *held* that the release contained in Modification No. 5 terminated all claims arising out of defendant's occupancy of the leased premises, and plaintiff is accordingly barred from asserting a claim growing out of defendant's said occupancy. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

**Contracts; release; release without exception.**

[1] A Contractor who executes a general release cannot thereafter successfully maintain a suit, either for damages or for amounts allegedly due under the contract, based upon events which occurred prior to the execution of the release. (*H.L.C. & Assoc. Constr. Co.* v. *United States*, 176 Ct. Cl. 285, 367 F. 2d 586 (1966).)

Release ⚷ 38

**Contracts; release; release without exception; claim "under the contract".**

[2] Where plaintiff's present claim seeking just compensation under the Fifth Amendment, i.e., rental payments at a higher rate for the period when defendant was a holdover tenant of the formerly leased premises, had its genesis by virtue of the contractual relationship between the parties, a relationship from which plaintiff released "all claims and disputes of every kind whatsoever, known and unknown, under this contract" in an agreement executed after defendant had vacated the premises, the release encompassed and bars plaintiff's claims. Without a reservation of a claim for additional rent, the broad general language of the "all claims" release and the objective intent of the parties to effect a final closing of all matters arising out of their rental contract must be given legal effect.

Release ⚷ 39

*William H. Fox*, attorney of record, for plaintiff.

*Bruno A. Ristau*, with whom was *Assistant Attorney General Carla A. Hills.*

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and NICHOLS, *Judge.*

Opinion of the Court

DURFEE, *Senior Judge*, delivered the opinion of the court:

On January 1, 1966, defendant acting through the United States Air Force leased [1] from plaintiff, Urbanizadora Santa Clara, S. A., a Spanish real estate corporation, a housing project in Seville, Spain. The housing project consisted of some 232 buildings plus garden and open space, and contained 494 residential housing units. The lease, which expired by its own terms on September 26, 1968, provided for monthly rental payments of $51,870 and contained no renewal provisions. Prior to the expiration of this lease, the parties conducted negotiations in an attempt to execute a follow-on lease. While these negotiations resulted in an agreement between the parties' negotiating representatives for an additional rental period at the increased monthly rate of $62,738, the agreement was never approved, as required, by the Secretary of the Air Force or his duly authorized representative. At the expiration of the lease, on September 26, 1968, the Air Force held over in possession of the housing development, and continued to pay rent at the previous rate of $51,870 under the now expired lease.

Plaintiff, on March 3, 1969, brought a civil action in Municipal Court No. 6 of Seville, Spain seeking an eviction order against the United States for the leased premises. The Municipal Court asserted jurisdiction under the Spanish Civil Code, and denied plaintiff's claim, as under the Spanish Law of Leases the United States as lessee by the original lease could validly hold over under that lease. Plaintiff subsequently appealed the decision of the Municipal Court to the Court of First Instance of Seville, the appellate tribunal over the Municipal Court. That court revoked the judgment of the Municipal Court on February 18, 1970, finding that the Municipal Court's assertion of jurisdiction under the Spanish Civil Code was critically defective. The appeals court, in revoking the judgment below, noted that jurisdiction did exist under the Spanish Law of Leases which allowed defendant to hold over; however, that court decided the appeal on jurisdictional grounds and expressed no opinion as to the merits of the suit. Plaintiff declined to seek further review of the Court of First Instance's judgment or reinstate the suit in the Municipal Court on proper jurisdictional grounds.

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[1] The lease agreement was designated Contract No. AF 61 (322)-1050.

By letter dated January 29, 1970, defendant notified plaintiff that it would terminate its holdover tenancy and vacate the premises no later than May 25, 1970. Defendant did in fact vacate the premises by May 25, 1970.

Following defendant's termination notice, the parties negotiated in an effort to settle a variety of disputes and claims concerning termination procedures and amounts due plaintiff for rehabilitation of the housing units. These negotiations resulted in a series of settlement agreements which the parties formalized by the execution of modifications to the original contract. All of these modifications were executed after the September 26, 1968 expiration date of the original contract, and three were executed after defendant vacated the housing project on May 25, 1970.[2]

By Modification No. 5,[3] executed July 31, 1973, the parties agreed to a settlement of "all remaining claims" under the

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[2] A summary of the subject matter and execution dates of the preceding four contract modifications is set forth in Modification No. 5, appearing in full, *infra*, n. 3.

[3] SUPPLEMENTAL AGREEMENT FOR FULL SETTLEMENT OF CLAIMS

This Supplemental Agreement of Settlement for Reservations, Modification Number 5, to Contract No. AF61 (322)–1050, for settlement of termination claims under said contract, is entered into this 31st day of July 1973, between the Government of the United States of America (hereinafter referred to both as "the lessee" and "the Government"), represented by the Termination Contracting Officer executing this contract modification, and Urbanizadora Santa Clara, S.A. (hereinafter referred to both as "the lessor" and "the contractor"), represented by Senor Enrique Fernandez de Bobadilla as General Manager thereof, for the purpose of the lease (Contract AF61 (322)–1050 electing as domicile Calle Equilus, Nos. 4 and 6, Jerez de la Frontera, Cadiz, Spain, a corporation organized and existing under the laws of Spain WITNESSETH THAT:

WHEREAS, the lessor and the Government have entered into Contract No. AF61 (322)–1050 under date of 25 June 1965 which, together with any and all amendments, changes, modifications, and supplements thereto, is hereinafter referred to as "the contract"; and

WHEREAS, by notice of termination dated 16 February 1970, the Government advised the lessor of the complete termination of the contract for the convenience of the Government, effective upon the close of business 25 May 1970; and

WHEREAS, Modification No. 1, dated 10 April 1970, was executed in connection with the termination of this contract to establish termination procedures; and

WHEREAS, Modification No. 2, dated 16 April 1970, settled certain claimed items regarding the housing project in general and settled all claims for rehabilitation of seven (7) housing units which had been substantially rehabilitated by Air Force contract. Payment of $16,311.05 has been made in settlement thereof; and

WHEREAS, Modification No. 3, dated 29 January 1973, specifically identified two hundred seventy five (275) housing units that had been substantially contract, and plaintiff accepted a lump sum payment of $342,873.21. That Modification contained the express release that:

> In consideration of the payment of the sum of $342,873.21 as provided herein and in consideration of all other terms of this agreement, the contractor does hereby release, discharge and settle any and all claims and disputes of every kind whatsoever, known and unknown, under this contract which the contractor may have against the Government. The contractor will, in consideration of the terms of this agreement, dismiss with prejudice its appeal number 16812 before the Armed Services Board of Contract Appeals.

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rehabilitated by Air Force contract and then jointly conditioned surveyed, and as a result of negotiations provided an amount of Seventeen Thousand, Eight Hundred Forty-Nine dollars and Six cents ($17,849.06) for additional rehabilitation work to be performed by the Lessor (Urbanizadora Santa Clara, S.A.); and

WHEREAS, Modification No. 4, dated 25 July 1973, settled specific set aside claimed items regarding the housing project and payment of $46,978.19 will be made in settlement thereof;

Now therefore, by this Modification No. 5, the parties hereby agree to a settlement of all remaining claims and the lessor accepts an additional lump sum payment of Three Hundred Forty-two Thousand, Eight Hundred Seventy Three dollars and Twenty-one cents ($342,873.21) for full settlement of all remaining claims now known or ever to be known under the contract.

In consideration of the payment of the sum of $342,873.21 as provided herein and in consideration of all other terms of this agreement, the contractor does hereby fully release, discharge and settle any and all claims and disputes of every kind whatsoever, known and unknown, under this contract which the contractor may have against the Government. The contractor will, in consideration of the terms of this agreement, dismiss with prejudice its appeal number 16812 before the Armed Services Board of Contract Appeals.

It is further agreed that this settlement agreement shall not be effective and binding upon either party unless it is executed by both parties and approval thereof is given by the United States Air Forces Europe Contract Termination Settlement Review Board and the AFLC/JAB Trial Attorney on or before the 20th day of August 1973.

Written evidence of such approval shall be given, either to the Lessor at his business address or to the Lessor's attorney * * * on or before the 20th day of August 1973.

IN WITNESS WHEREOF, the parties herein have executed this agreement as of the date above written.

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|---|---|
| THE LESSEE | THE LESSOR |
| THE GOVERNMENT OF THE UNITED STATES OF AMERICA | URBANIZADORA<br>SANTA CLARA, S.A. |
| BY: | BY: |
| DAVID L. WALKER, III, Major, USAF<br>TERMINATION CONTRACTING OFFICER | ENRIQUE FERNANDEZ<br>DE BOBADILLA<br>GENERAL MANAGER |

The agreed payment was made to plaintiff on September 10, 1973, and plaintiff dismissed with prejudice its appeal before the Armed Services Board of Contract Appeals.

On July 30, 1974, plaintiff filed suit in this court seeking just compensation from the United States under the Fifth Amendment,[4] of $222,640.00, the difference between the monthly rental payments under the expired contract ($51,870) and agreed but unapproved rate ($62,738) for the holdover period, September 26, 1968 through May 25, 1970.

Defendant contends that this claim is barred by plaintiff's execution of the release contained in Modification No. 5. Plaintiff maintains that the release in Modification No. 5 may have released claims "under the contract", but the instant claim is founded on the Fifth Amendment, and not under the contract, and that its claim arose after the contract between the parties had expired.

As we are of the opinion that the release contained in the parties' Modification No. 5 bars this claim, defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and its petition is dismissed.

The principle "that a contractor who executes a general release cannot thereafter successfully maintain a suit, either for damages or for amounts allegedly due under the contract, based upon events which occurred prior to the execution of the release"[5] has been established both by this court and the Supreme Court. *J. G. Watts Constr. Co.* v. *United States*, 161 Ct. Cl. 801 (1963); *H. L. C. & Associates Constr. Co.* v. *United States*, 176 Ct. Cl. 285, 367 F. 2d, 586 (1966); *Adler Constr. Co.* v. *United States*, 191 Ct. Cl. 607, 423 F. 2d, 1362 (1970); and *United States* v. *Wm. Cramp & Sons Co.*, 206 U.S. 118 (1907). Plaintiff takes no issue with this statement of law. Nor does it contend that the release is in any way invalid, ineffective or contains any manner of reservation of its claim. Rather, plaintiff points out that the release by its own terms is limited to claims "under the contract" and its claim is not "under the contract" but under the Fifth Amendment. Defendant claims that plaintiff's suit is barred by the release in Modification No. 5, because in signing that document, plaintiff released "any and all claims * * * of every kind whatsoever". Thus, the dispositive issue in this suit, as far as this court is concerned, is whether the release contained in Modification No. 5 encompasses plaintiff's claim.

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[4] U.S. Const. amend. V.

[5] *H.L.C. & Associates Constr. Co.* v. *United States*, 176 Ct. Cl. 285, 293, 367 F. 2d, 586, 590 (1966).

The release provision in Modification No. 5 was executed nearly five years after the stated expiration date of the original contract, and more than three years past the defendant's termination of occupancy, as the last of a series of agreements intended to settle claims arising out of the United States' occupancy of plaintiff's housing project. The Modification recited *inter alia* the existence of a contract between plaintiff and defendant, the notification by the United States to plaintiff "of the complete termination of the contract * * * upon the close of business 25 May 1970" and the parties' agreement "to a settlement of all remaining claims".

Judging the conduct of the parties and the terms of Modification No. 5, with its release provision, on its face, it is clear that plaintiff's claim comes within the release provision, and is barred thereby.

Plaintiff's claim for additional rent during the holdover period, September 26, 1968 through May 25, 1970, framed as a petition for just compensation, arose prior to Modification No. 5 during a time in which the parties were attempting to settle their differences over defendant's occupancy of plaintiff's property. The claim came about only because of the parties' original rental contract. It was from this contract and under it that plaintiff's present claim germinated. The contract placed defendant in possession of plaintiff's property, the occupancy of which gave rise to the present claim, and from which plaintiff released without reservation all claims "of every kind whatsoever". As plaintiff's claim had its genesis by virtue of the contractual relationship between the parties, a relationship from which plaintiff released all claims, plaintiff is now barred from asserting a claim growing out of defendant's occupancy pursuant to the contract.

Plaintiff's argument that its claim does not arise "under the contract" as its rental contract with defendant expired by its own terms on September 26, 1968, and therefore no contract was in effect during the holdover period for which it claims ignores the fact that but for that rental contract and defendant's occupancy of plaintiff's project, thereunder, there would be no claim. *See*, *United States* v. *Wm. Cramp & Sons Co.*, 206 U.S. 118, 128 (1907).

Further, it is not apparent how plaintiff can argue that the release applies only to the contract period, January 1965 through September 26, 1968 when it continued to negotiate and execute modifications to alter the "expired" contract for a period of nearly five years subsequent to the 1968 expiration date. The last modification to which plaintiff agreed states:

> WHEREAS, by notice of termination * * * the Government advised the lessor of the complete termination of the contract * * * effective upon the close of business 25 May 1970.

It is apparent from the parties' actions and the language of the release that the parties intended to bring to a final close their dealings with respect to the rental of plaintiff's housing project. After the Government's termination notice the parties ceased negotiations as to an additional rental period, and concentrated on settlement of termination procedures and rehabilitation claims. Modifications Nos. 1 and 2 were executed toward this end. By May 25, 1970 defendant had completely vacated the rental property. Modifications Nos. 3 and 4, executed after the termination of defendant's tenancy, settled specific claims in respect to that termination. Modification No. 5, the last of the parties' agreements, was executed in "settlement of all remaining claims" and contained a general release of all claims. The whole tenor of the parties' agreements culminating in Modification No. 5 indicates their intention to completely end their relationship, and to settle forever obligations "of every kind whatsoever" arising from defendant's occupancy of plaintiff's property. Modification No. 5, titled Supplemental Agreement for Full Settlement of Claims, recites the parties' agreement "for full settlement of all remaining claims now known or ever to be known under the contract". The release language itself specifies that:

> * * * the contractor does hereby fully release, discharge and settle any and all claims and disputes of every kind whatsoever, known and unknown, under this contract which the contractor may have against the Government.

The broad and all inclusive language of the Modification and the release clearly evidences an intent on the part of the parties to effect a final closing of all matters arising out of their rental contract. "Stipulations of this kind are not to be shorn of their efficiency by any narrow, technical and close construction". *United States* v. *Wm. Cramp & Sons Co.*, 206 U.S. 118, 128 (1907).

If plaintiff intended to preserve and pursue a claim for additional rent following the execution of the release, it was incumbent on plaintiff to manifest this intention in a clearly recognizable manner, *United States* v. *Wm. Cramp & Sons Co.*, *supra.* Without such a reservation the broad general language of the "all claims" release and the objective intent of the parties must be given legal effect.

Releases serve to terminate with finality legal obligations of the parties. Without well-established grounds,[6] not present here, claims covered by the release and not reserved, no matter how meritorious, cannot be judicially entertained unless the release itself is found to be defective. *Adler Constr. Co.* v. *United States*, 191 Ct. Cl. 607, 611, 423 F. 2d 1362, 1364 (1970).

Since we are of the view that the release contained in Modification No. 5, terminated all claims arising out of defendant's occupancy of plaintiff's property, plaintiff is not entitled to maintain a claim based on defendant's occupancy of its property. In light of that judgment, the court expresses no opinion as to the other arguments advanced by the parties.

Defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed.

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## WILLIAM H. FUNDERBURG v. THE UNITED STATES

[No. 71-74. Decided June 25, 1975]

### ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

**Civilian pay; suit for back pay; failure of promotion; racial discrimination claim.**—Plaintiff, a Negro and a former marine cargo specialist (GS-9) at the Naval Supply Depot (NSD), Seattle, Washington, seeks back pay and other lost employment benefits at a rate based on a higher grade level to which he alleges he was barred because of racial discrimination, and for restoration, at plaintiff's election, to employment, together with correction of his records. Marine cargo specialists may be appointed in grades GS-7 through GS-12, depending on experience and other factors. Pursuant to a proposed merger of the Seattle terminal port operations of NSD and the Military Traffic Management and Terminal Service (MTMTS), plaintiff, along with six white marine cargo specialists, was detailed temporarily from NSD to MTMTS in April 1967. The merger was disapproved, and while some of the detailed employees were transferred to MTMTS and at various times in 1968 received promotions to GS-11, plaintiff remained a GS-9 NSD employee, either officially detailed to or otherwise under the supervision of MTMTS from April 1967 to April 6, 1970, during most of which period he performed the same duties as the MTMTS GS-11 employees. In March 1970 plaintiff's position at NSD was reclassified as GS-11, and on April 5 he was temporarily promoted to GS-11. In May 1970 he was notified that his position was to be abolished as a result of a reduction in force and that this action made him eligible for retirement. Plaintiff retired on July 31, 1970 with 29 years service. In June 1969 plaintiff filed an agency complaint alleging racial discrimination; the complaint was rejected. In May 1970 he filed a second racial discrimination complaint. The investigator found discrimination by MTMTS in failing to transfer plaintiff to a GS-11 position, but discrimination due to race was not found, nor did the report indicate any racial incident or any atmosphere of racial discrimination. The complaint was rejected on the grounds that it was untimely, that it was automatically cancelled by plaintiff's retirement, and that the requested relief—retroactive promotion and back pay—could not be legally granted. The Civil Service Commission affirmed the rejection, and thereafter plaintiff sued in a district court challenging the decision; the court remanded the matter to CSC to make findings of fact so that the discrimination complaint might be processed in accordance with law. On remand the Navy rejected plaintiff's complaint, finding that delay in promotion was the result of plaintiff's unsatisfactory performance, the Secretary of the Navy concurring in this conclusion. Plaintiff's suit in this court followed. Upon review of the record, the court points out that there is no single, specific instance of racial discrimination, and concludes that the evidence shows that the "discrimination" in grade level was the product of plaintiff's unsatisfactory performance record. It is *held* that plaintiff has failed to sustain his claim of racial discrimination. Defendant's motion for summary judgment is granted and the petition is dismissed.

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[6] *See, J .G. Watts Construction Co.* v. *United States*, 161 Ct. Cl. 801, 806–807 (1963).

**Pleading and practice; summary judgment; response to motion for summary judgment.**

**[1] Where plaintiff, in opposing a motion for summary judgment, fails to set forth specific facts showing a triable issue as to the alleged racial discrimination which prevented or delayed his promotion, he does not comply with Rule 101(f), particularly in view of the extensive, detailed record before the court showing that the alleged discrimination in grade levels was the product of plaintiff's unsatisfactory performance record demonstrating that he was not qualified for promotion. Mere formal denials and general allegations are insufficient to prevent the award of summary judgment.**

**Courts 🔑 470**

**Civilian pay; racial discrimination; failure to promote; evidence.**

**[2] A *prima facie* case of failure to promote because of racial discrimination is made by showing that plaintiff belongs to a racial minority, that he was qualified for promotion and might have reasonably expected selection for promotion under the defendant's ongoing competitive promotion system, that he was not promoted, and that the supervisory level employees having responsibility to exercise judgment under the promotion system betrayed in other matters a predisposition towards discrimination against members of the involved minority. *Pettit* v. *United States*, 203 Ct. Cl. 207, 488 F. 2d 1026 (1973).**

**United States 🔑 36**

**Civilian pay; appointment and tenure; administrative or executive function; compensation, entitlement and amount.**

**[3] A Government employee is entitled only to the salary of the position to which he is appointed, regardless of the duties he actually performs.**

**United States 🔑 39(2)**

*Sidney J. Strong*, attorney of record, for plaintiff.

*John W. Showalter*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before SKELTON, KUNZIG, and BENNETT, *Judges*.

BENNETT, *Judge*, delivered the opinion of the court:

Defendant has moved for summary judgment and dismissal of plaintiff's petition which alleges that plaintiff was the victim of racial discrimination in his civilian employment with the Government. Plaintiff opposes the motion and argues that there are issues of fact requiring a trial. We hold for defendant and reject plaintiff's demand for back pay;

for benefits at a rate based on a higher grade level to which plaintiff alleges he was barred because of racial discrimination; for restoration; and for correction of plaintiff's record. All facts necessary to decide the motion are before us.

## I

During the period relevant to this dispute, plaintiff was a civilian employee of the Naval Supply Depot (NSD), Seattle, Washington, working as a marine cargo specialist (GS-9). The NSD provided terminal port services for military cargo and passengers using the Seattle port facility. A marine cargo specialist's duties, as described in agency regulations, include planning for stowage of marine cargo aboard carrier vessels, and maintaining surveillance of loading and discharge operations. Such an employee is concerned with maximum utilization of vessel space, safety of cargo, and efficient use of labor and equipment in the loading and discharge of cargo. Marine cargo specialists may be appointed in grades GS-7 through GS-12, depending on experience and other factors.

Pursuant to an Interservice Support Agreement, when the NSD provided terminal port services for the Department of the Army at Seattle piers, it would bill the Army, represented by the Military Traffic Management and Terminal Service (MTMTS), for those services. The MTMTS also performed terminal port services at Seattle. On March 6, 1967, it was proposed by MTMTS that its operations in Seattle be merged with some NSD operations in order to prevent duplication of effort. Included in the proposal was the suggested transfer of marine cargo specialist positions from NSD to MTMTS. In contemplation of the proposed merger of operations, six marine cargo specialists (GS-9) and one supervisory marine cargo specialist (GS-11) were "detailed"[1] temporarily from NSD to MTMTS on April 14, 1967. Plaintiff was among the six GS-9 employees so detailed and was the only black marine cargo specialist in the group.

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[1] It should be understood that an employee who was "detailed" to MTMTS remained a Navy employee, though under the supervision of the Army. An employee "transferred" to MTMTS, on the other hand, became an Army employee.

The proposed merger of NSD and MTMTS operations was ultimately disapproved by higher authority. As a result, the detail of the seven NSD marine cargo specialists officially ended June 30. Notwithstanding the disapproval, there followed a series of transfers of marine cargo specialists from NSD to MTMTS with the end result that plaintiff remained an NSD marine cargo specialist at the GS-9 level, while the other five of the original group of six GS-9 marine cargo specialists became MTMTS marine cargo specialists at the GS-11 level. Specifically, three of the GS-9 specialists were transferred to MTMTS at grade GS-11 on August 26, 1967; the GS-11 supervisory marine cargo specialist was transferred to MTMTS on October 23, 1967; and the remaining two GS-9 specialists were transferred on February 17, 1968, and August 3, 1968, respectively.

Although never "transferred" to MTMTS, plaintiff was either officially detailed to, or otherwise under the supervision of, MTMTS during the entire period of April 1967 to April 5, 1970. Taking the facts most favorably to plaintiff, as we must do where defendant has moved for summary judgment,[2] plaintiff performed the same duties as those performed by the GS-11 employees of MTMTS during that period, with the exception of the span December 16, 1968 to February 17, 1969, during which time plaintiff was assigned to preplanning in the MTMTS office for training. On March 30, 1970, plaintiff's position at NSD was reclassified as grade GS-11. On April 5 plaintiff was promoted on a temporary basis to the grade of GS-11.

Plaintiff was notified on May 1, 1970, that his position was to be abolished as a result of a reduction in force and that this action made him eligible for retirement. Having served 29 years with the Government, plaintiff retired on July 31, 1970.

## II

Plaintiff alleges that his continued association with NSD at the GS-9 level until April 5, 1970, while his contemporaries were being transferred to the MTMTS at a grade of GS-11, was the product of racial discrimination. We believe that the facts prove otherwise.

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[2] *United States* v. *Diebold, Inc.*, 369 U.S. 654 (1962).

Plaintiff was not transferred to MTMTS and promoted to the grade of GS-11 because the MTMTS believed his work was unsatisfactory. As stated above, plaintiff was relieved of his normal duties on December 16, 1968, and assigned to preplanning in the MTMTS office for training. This was done because plaintiff's performance had been less than satisfactory, and this additional training was intended to improve that performance. Plaintiff's supervisor in MTMTS wrote to the NSD on April 29, 1969:

> 2. As a result of the meeting with you in Mid-December, Mr. Funderburg was assigned to assist in preplanning from 16 December 1968 until 17 February 1969 so that he would be available for orientation and be greater exposed to the experience of other Marine Cargo Specialists. The stow plans prepared by Mr. Funderburg during the entire two month period are attached. (Incl 2) An analysis of the work performed shows that the simple plans required revision or were layed out by other personnel. The complicated plans required complete revision and most plans he prepared are unacceptable. Because of the duplication of effort we cannot accept him as a planner. Since returning to the direct supervision of vessels on 17 February 1969 I have summarized all of the vessels under his direction and the apparent conclusion supports the contention that he does not meet the qualifications necessary to fulfill the standards expected of him in this position.

Plaintiff's performance was also considered to be deficient during the early months of 1969. In that same letter of April 29, his supervisor wrote:

> His work record leaves much to be desired as was presented to you over three months ago. That evaluation has not changed for he is completely dependent on others including contract personnel to arrive at any decision. Answering (sic) to questions raised to him are delayed and subsequent investigation reveals that he returned to the job to determine the answer from contract personnel. He does not demonstrate any individual initiative and requires detailed instruction to perform any task. His repetitious errors reflect a lack of knowledge and understanding of the job. His reports are a constant source of correction due to omission or misinterpretation of the stevedore contracts. He lacks the initiative, aggressiveness and fortitude necessary to direct the work of others in this position. * * *.

The above statement by the supervisor was followed by 13 specific illustrations of defects in plaintiff's work, and several contained numerous subsidiary illustrations of specific incompetent work by plaintiff.

On May 19, 1969, plaintiff was issued a Letter of Warning by the NSD, based on the April 29 letter from plaintiff's MTMTS supervisor, a copy of which accompanied the Letter of Warning. The latter stated that plaintiff's work did not meet the standards necessary to fulfill the duties of plaintiff's position. He was assured of any assistance required but warned that he must show improvement by August 22, 1969, or "other action may be taken." The MTMTS informed NSD on September 25, 1969, however, that plaintiff had "responded favorably" since the Letter of Warning and was now considered to be performing his assigned duties "in a satisfactory manner." On January 23, 1970, plaintiff was rated as eligible for a within-grade step increase due March 8, 1970. On April 1, 1970, plaintiff received a "satisfactory" performance rating for the period March 31, 1969 to March 31, 1970. On April 5, plaintiff was promoted to the temporary grade of GS-11, step 1.

## III

Plaintiff first charged the Government with racial discrimination in a letter, written by his attorney, on June 3, 1969. The "specific complaints" set out in the letter were:

> * * * (1) failure to upgrade to GS-11, (2) discriminatory work assignments, and (3) improper conduct and behaviour of the Marine Superintendent, Mr. Maurice.

The MTMTS assigned an investigator to investigate the charges. The report of the investigator, dated July 11, 1969, stated that seven employees had been interviewed, including plaintiff, and 15 personnel files examined. The conclusions reached by the investigator were:

> 1. It is my opinion that Mr. Funderburg was not selected for GS-11 because he is not qualified, not because he is colored. The record speaks for itself.
> 2. That Mr. Funderburg has made many costly mistakes that disqualify him for GS-11.
> 3. That Mr. Funderburg does not have the necessary experience for GS-11.

4. That Mr. Funderburg although given extra help in his work is still far from qualifying for GS–11.

5. That Mr. Funderburg has not exhibited the necessary initiative to prove himself capable and qualified for GS–11.

6. That promotion in MTMTS to GS–11 or any grade is based on ability and qualifications.

7. That no discrimination exists in MTMTS against Mr. Funderburg or anyone else, either with regard to the promotion to GS–11 or any other assignment.

The "improper conduct and behaviour" of Mr. Maurice was found to have consisted of using profanity on the docks to all those under his supervision, a not uncommon practice in that line of work. The MTMTS rejected plaintiff's complaint on August 5. Plaintiff at first appealed that decision to the Civil Service Commission, then on September 4, 1969, withdrew the appeal and request for a hearing.

A second racial discrimination complaint was filed by plaintiff on May 23, 1970. The filing of this complaint came after plaintiff had been temporarily promoted to the grade of GS–11 and notified that he would be subject to an impending RIF. Again the crux of the complaint was that he had been performing the same duties while a GS–9 as others who were at the GS–11 grade. His requested relief was retroactive promotion and back pay. Through a misunderstanding due in part to the fact that plaintiff retired from the Government shortly after filing the complaint, the complaint was not at first formally processed. Subsequent communications between the Navy and plaintiff's attorney, however, resulted in an investigation into the charge, the results of which were reported on April 2, 1971. The investigator, after reciting the facts concluded:

> There is basis for Mr. Funderburg's feeling that he was discriminated against. It is believed that the actual discrimination was done by MTMTS in failing to transfer him to a GS–11 position, the duties of which he was apparently performing.

It must be noted that the investigator did not conclude that there was discrimination *due to race*, nor was there a shred of evidence elicited in that report of any racial incident or any atmosphere of racial discrimination. Plaintiff mischaracterizes the report as raising a triable fact of racial discrimination. The report did not find such discrimination.

Plaintiff's complaint was thereafter rejected by the Department of the Navy on the grounds that it was untimely filed, that it was automatically canceled (according to applicable regulations) by plaintiff's retirement for reasons not related to his complaint, and that plaintiff's requested relief—retroactive promotion and back pay—could not be legally granted. The Civil Service Commission upheld this determination on August 31, 1971. Plaintiff challenged the CSC's decision by suit in the Federal District Court for the Western District of the State of Washington. That court, unhappy with the failure of the agency to make findings of fact to support its decision, remanded the matter to the CSC (and hence to the agency) so that the discrimination complaint might be processed in accordance with law.

The Government thereupon undertook a third investigation of plaintiff's complaint to resolve these issues: (1) was the complaint timely filed, (2) was plaintiff's separation (retirement) from the Navy related to his complaint, and (3) was plaintiff denied promotion to GS-11 without due cause? The third investigation report concluded that all three questions were answerable in the negative. Plaintiff's "delay"[3] in promotion to grade GS-11 was found to be the result of his unsatisfactory performance. On the basis of this report, plaintiff's complaint was again denied. On appeal, the Secretary of the Navy on February 4, 1974, concurred in the denial. Plaintiff was advised by the Secretary of his right to appeal to the CSC within 15 days or to sue in the district court within 30 days. Plaintiff did neither but filed his petition in this court on March 7, 1974,[4] demanding back pay and restoration of all lost employment benefits arising from the alleged discrimination.

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[3] Though not a factor in our decision herein, it is interesting to note that from February 1966 to April 1970, a period of only 4 years, plaintiff rose from grade WB-5 to grade GS-11. Because of the Whitten Amendment, 65 Stat. 758 (§ 1310(c) and (d)); 5 U.S.C. § 3101 Notes, plaintiff could not have been promoted to grade GS-11 until March 12, 1968, 1 year after he had been promoted from GS-7 to GS-9.

[4] Plaintiff's failure to appeal first to the CSC is alleged by defendant to be a failure to exhaust administrative remedies for which the petition should be dismissed. Our decision against plaintiff on the merits obviates consideration of that issue. For the same reason, we do not discuss plaintiff's questionable implication that we could promote and reclassify him as a basis for granting the relief he claims.

## IV

In all of the record before this court, including 43 exhibits of the parties, there is not a single, specific instance of racial discrimination that has been brought to our attention. Plaintiff relies solely on the fact, which we have assumed to be true, that for a certain period of time, he was performing duties, while being paid at the GS-9 level, that others were performing while paid at grade GS-11. The evidence shows, however, that this "discrimination" in grade levels was the product of plaintiff's unsatisfactory performance record. There is no basis for believing that race was a factor.

Plaintiff's affidavit to the court, one of the 43 exhibits referred to above, includes the following statement:

> I was the only black and the only Marine Cargo Specialist at the GS-9 rating. I was continually subject to ridicule and harassment. I was the recipient of racist comments. * * *.

The above statement does not allege racial discrimination against plaintiff's supervisors which prevented or delayed plaintiff's promotion. But even if it were so read, it would be insufficient to prevent the issuance of summary judgment for defendant on the basis of the extensive, detailed record before us. Our case of *Burton* v. *United States*, 186 Ct. Cl. 172, 404 F. 2d 365 (1968), *cert. denied*, 394 U.S. 1002 (1969), which also involved a motion for summary judgment founded on a claim of racial discrimination, is closely on point. In it we said at 186–87 (404 F. 2d at 373):

> We recognize that our analysis of the case might all be valid and still there might be a triable issue of fact. This would be the case, *e.g.*, if plaintiff intended by oral testimony, his own or that of others, to contradict, explain, or modify the story that emerges so plainly from the record. The trouble is, under Rule 64 [presently Rule 101(f)], plaintiff is required, in opposing the motion for summary judgment, to set forth specific facts showing there is a triable issue.

* * * * *

> In all this lengthy record there is no evidence that any person or persons concerned with the promotion of plaintiff, his separation from service, and the review by the CSC, acted with a racial bias against plaintiff. In *Madison*, *supra*, at p. 989, we said that imputations of bad faith or malevolence by the employee against management preclude summary judgment and raise a triable issue "if plaintiff has shown enough to call for a trial on that issue." It is our considered judgment here that plaintiff has not shown enough, or indeed, anything at all. * * *. [*Cf.* FRCP 56(e).]

On many other occasions we have said that mere formal denials and general allegations are insufficient to prevent the award of summary judgment. *See, e.g.*, *Pacific Far East Line, Inc.* v. *United States*, 206 Ct. Cl. 378, 513 F. 2d 1355 (1975); *Walker* v. *United States*, 192 Ct. Cl. 805, 810, 428 F. 2d 1229, 1231 (1970).

Furthermore, plaintiff does not show all of the elements which were found in *Pettit* v. *United States*, 203 Ct. Cl. 207, 488 F. 2d 1026 (1973), to make out a prima facie case of racial discrimination.[5]

Plaintiff says that he does not dispute the need to show the requirements established by *Pettit* but insists that they have been satisfied. Yet, there is no allegation that "the supervisory level employees having responsibility to exercise judgment under the promotion system betrayed in other matters a predisposition towards discrimination against members of the involved minority." Assuming, therefore, that *Pettit* is a viable precedent, plaintiff has not, as he alleges, brought his case within the guidelines of that decision.[6] Nor does plaintiff specifically attempt to refute defendant's position that plaintiff's job performance was unsatisfactory, *i.e.*, that plaintiff was not qualified for promotion.

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[5] In *Pettit*, this court stated at 220 (488 F. 2d at 1033):

"* * * We, therefore, hold that a prima facie case of failure to promote because of racial discrimination is made by showing: (i) that plaintiff belongs to a racial minority, (ii) that he was qualified for promotion and might have reasonably expected selection for promotion under the defendant's on-going competitive promotion system, (iii) that he was not promoted, and (iv) the supervisory level employees having responsibility to exercise judgment under the promotion system betrayed in other matters a predisposition towards discrimination against members of the involved minority. * * *."

[6] The author of the instant opinion dissented in *Pettit*, a case in which the court was divided 4–3.

**Syllabus**

V

Unable to sustain his claim of racial discrimination, plaintiff's claim for back pay must fail. Except where there is legal entitlement to a higher position, which is not the case here, a Government employee is entitled only to the salary of the position to which he is appointed, regardless of the duties he actually performs. *Hirsch* v. *United States*, 205 Ct. Cl. 256, 499 F. 2d 1248 (1974); *Ganse* v. *United States*, 180 Ct. Cl. 183, 376 F. 2d 900 (1967); *Tierney* v. *United States*, 168 Ct. Cl. 77 (1964); *Price* v. *United States*, 112 Ct. Cl. 198, 80 F. Supp. 542 (1948).

Defendant's motion for summary judgment is granted. Plaintiff's petition is dismissed.

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518 F. 2d 1199

# ALBERT H. CARTER v. THE UNITED STATES

[No. 127-66. Decided June 25, 1975]*

OPINION

**Military pay; discharge; show cause proceeding under AFR 36-2; burden of proof.**—In an opinion dated January 22, 1975 the court held that the discharge on December 29, 1960, of plaintiff, an Air Force reserve officer, under Air Force Regulation 36-2 shifting the burden of proof to the accused in a dishonorable or less than honorable discharge proceeding was unlawful; that plaintiff's discharge must be corrected to show that he was either honorably discharged or discharged under honorable conditions for unsuitability due to a severe character disorder; and that plaintiff was entitled to certain monetary benefits under the circumstances. Thereafter, plaintiff filed a motion for rehearing and defendant filed a motion for rehearing to alter and amend judgment, both parties also filing supporting briefs and replies. Defendant asserts that the Defense Department regulations referred to by the court relate to enlisted men and are inapplicable to this case, that the court misapprehended the critical differences between reserve and regular Air Force officers, and that the show cause procedure of AFR 36-2 does not violate due process where there is exposure to a stigma-type discharge. The court points out that its references to the Defense Department regulations have relevance as showing the policy of the DOD as to a matter analogous to the present case, i.e., the award of stigma-type discharges to en-

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*Plaintiff's petition for certiorari was *denied* January 19, 1976.

listed men. After again reviewing the Guidance Manual implementing AFR 36-2, the court points out that plaintiff was placed in a position where, to retain his commission, he had to carry the burden of proof, the Manual expressly saying this. Defendant contends that the procedure of AFR 36-2 merely formalizes the accused's obligation to meet in a full adversary context, the *prima facie* case created by the evidence presented by the Air Force, and that in reality the burden is on the Air Force. The court accepts this interpretation but notes this was not how AFR 36-2 was applied to Captain Carter. The court also points out that in its prior decision it expressly limited the decision to what the court supposed to be a rare situation, i.e., imposition of a stigma-type discharge in a show cause proceeding in which the accused bore the burden of proof. The court *affirms* its judgment, denies defendant's motion to the extent it seeks dismissal of the petition, allows the motion to the extent of the revisions noted in the instant opinion, denies plaintiff's motion, and denies both parties' suggestions for rehearing *en banc*.

**Pleading and practice; motion for reconsideration or rehearing.**

[1] Where the court resolves a controversy via a solution suggested by neither party, the court is required to consider a motion for reconsideration or rehearing with exceptional care.

Courts 🔑 469

**Military pay; discharge; discharge under other than honorable conditions; show cause proceeding; burden of proof.**

[2] In a show cause proceeding under Air Force Regulation 36-2 where the imposition of a stigma-type discharge is under serious consideration the Air Force bears the burden of proof.

Armed Services 🔑 11

*Albert H. Carter, pro se.*

*Leslie H. Wiesenfelder*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before DAVIS, NICHOLS, and KASHIWA, *Judges.*

PER CURIAM: The court has considered the motions of plaintiff for rehearing and defendant's for rehearing to alter and amend judgment, relating to the court's opinion of January 22, 1975, 206 Ct. Cl. 61, 509 F. 2d 1150, the briefs in support thereof, and the replies thereto.

We have decided to allow defendant's motion in substantial part, but without dismissing the petition. As defendant says, the court took a line of its own selection. After the efforts of all concerned appeared only to add to the confusion of the record and render the issues more numerous and complex, we found what we considered a suitable key to resolution of the case, suggested by neither side. In the circumstances, we are required to consider motions for rehearing with exceptional care. *General Electric Co.* v. *United States*, 189 Ct. Cl. 116, 117, 416 F. 2d 1320, 1321 (1969). We have done so.

Defendant makes much of our error in citing Department of Defense Regulations, 24 Fed. Reg. 1704, and parts 41 and 44 of Title 32, Code of Federal Regulations, that relate to enlisted men. Plaintiff was an officer. Defendant admits there are no corresponding provisions for officers. The references have relevance as showing the policy of the Department of Defense as to a matter analogous to the one before us, *i.e.*, the award of stigma-type discharges to enlisted men. We assume the Department would not say it would refuse officers in jeopardy of such discharges comparable protection. However, the references in the slip opinion should be and are amended as follows:

Page 2. 6 lines from bottom, place period after "decorations"—delete remainder of sentence.

Page 6. Delete sentence starting the second full paragraph, which begins, "The Defense Department * * *"

Page 8. Last sentence on the page. Delete entire sentence.

Page 9. First sentence after the word "specification" insert "in the case of enlisted men,"

Page 10. 8 lines from bottom—Change the comma after "court" to a period—delete remainder of sentence.

Defendant also points out that Carter was not in jeopardy of, and was not awarded, an undesirable discharge. Erroneous references to "undesirable discharge" are also corrected as follows:

Page 4. Part II. 7th line—delete "undesirable discharge" and insert "discharge under other than honorable conditions."

Page 5. Amend second sentence after second quote (line 19) to delete the words "an undesirable," and the comma following the word "dishonorable"

We turn to defendant's arguments as to substantive law. The one we deem to require the most attention is that we have misconstrued AFR 36-2, paragraph 4d, in that it does not really shift the burden of proof to the respondent in providing: "The burden rests upon the respondent to refute, rebut, or mitigate the evidence presented by the Air Force." Defendant says that the procedure merely formalizes the respondent's "obligation to meet in a full adversary context, the *prima facie* case created by the evidence presented by the Air Force * * *" and moreover, the courts have, it says, required AFR 36-2 discharges to be supported by "substantial evidence". Defendant goes so far as to urge that "the substantial evidence tests puts the burden of proof squarely on the Air Force."

Under AFR 36-2, paragraph 14b, the Board is to be furnished operating instructions in a Guidance Manual. Such a Manual was used in plaintiff's case and is in evidence.

The said Guidance Manual states at the outset, over the signature of the Chief of Staff:

> * * * You should keep foremost in your mind the fact that such a case prior to referral to you was carefully reviewed by a board which decided that this officer should be required to justify to your satisfaction his retention in the service.

The preface page states:

* * * * *

> d. Burden of proof [is] on respondent.

The Sample Letter of Notification states:

* * * * *

> 6. Unless you can successfully refute, rebut, or raise serious doubt as to the reasons contained in inclosure II, [*i.e.*, the charges] you may be discharged.

The Manual indicates that the board may pursue reasons for separation other than stated in the charges, called "newly discovered reasons." The Manual continues:

> * * * The respondent must *effectively* refute, rebut, or raise serious doubt as to the statement of reasons on which he has been selected to show cause or any additional reasons which may be developed by the board of

> inquiry as to why he should not be discharged * * * (emphasis in original).

The Manual also states:

> — The Air Force having stated its case, it became the respondent's responsibility to present the necessary evidence to refute the statement of reasons why he has been selected to show cause and any other reasons or information developed by the board. This refutation normally must consist of the presentation of some evidence more than a simple denial by the respondent.
>
> — The interests of the Air Force being paramount, board members must exercise extremely high personal vigilance to preclude undue compassion for the respondent affecting their decision. Further, board members must remain constantly aware of the main issue to be resolved and must not allow that issue to become confused through technicalities or tactics employed by the respondent or his counsel.

At the opening of the board proceeding, the Senior Board Member (presiding) is to address the respondent in part as follows:

> * * * You have been selected to "Show Cause," because in the opinion of a board of senior Air Force officers, you failed to achieve such standards as the Secretary of the Air Force has prescribed. The Air Force case is founded upon but is not limited to documents previously presented to you. If any additional reason or information is made available to this board, you will be so advised and afforded opportunity to prepare your defense. It is your responsibility to refute, rebut, or raise serious doubt as to the statement of reasons why you have been selected to show cause for retention, or any additional reasons here developed. This refutation or rebuttal will normally be substantiated by evidence more than a simple denial by you. You are also advised that this hearing is administrative in nature and is not subject to the rules and procedures governing court action.

Our interpretation of AFR 36-2 we thought derived support from the Manual, and was nowhere refuted therein. Assuming, however, that defendant is right, the question of improper command influence immediately arises. On defendant's interpretation, the Board received instructions which were unwarranted by the Regulation and stripped away the safeguards the Regulation provided.

Bearing on the improper command influence issue, we further note that the file which was in the board's possession during its deliberations, and with which Carter was required to admit familiarity, included an endorsement over the signature of Francis H. Griswold, Lieutenant General, USAF, Vice Commander in Chief of SAC, and therefore the common superior of Carter and all the Board members. Among other things, the endorsement states:

> * * * An evaluation of the attached file indicates that Captain Carter has established a pattern of seeking every means of avoiding his obligations, with consequent embarrassment to his military superiors. His calculated conduct is incompatible with the standards expected of a commissioned officer. This Command believes that release and subsequent hearing under AFR 45–40 would serve the best interests of the United States Air Force in that such a procedure would deny the officer further opportunity to involve the service in his manipulations, and still provide him with an appropriate forum in which to air his claims of propriety and good faith. * * *

This communication also indicates that General Griswold did not desire Carter to receive a stigma-type discharge, for he says:

> * * * his offenses would not normally result in discharge under other than honorable conditions. * * *

General Griswold also desired a different procedure under which Carter would be released before the hearing. It is clear, however, that he considered that Carter was guilty and should be got rid of. Moreover, Griswold was speaking for the SAC commander, to whom the previous endorsement was addressed.

Reading this endorsement with the Manual provisions earlier quoted, the Board Members could have had little doubt as to what their duty was respecting Carter, unless he produced exculpatory evidence of some unforeseen kind. Instead, he displayed his usual self, and his doom was sealed.

We have no doubt, therefore, that Carter was placed in a position where to retain his commission, he had to carry the burden of proof. The Manual expressly says this. There is nothing to show a different allocation of burden as to his jeopardy to a stigma-type discharge, as defendant also urges without support of authority. If AFR 36–2 does not authorize this, as defendant now urges it does not, that is good news for civil libertarians, but it does not help defendant to win this case.

By accepting, as we do, defendant's interpretation of AFR 36–2, we avoid having to consider defendant's forebodings as to the impact our decision will have. However, we would point out in self-defense that we expressly limited it to what we supposed to be a rare situation, *i.e.*, imposition of a stigma-type discharge in a show cause proceeding in which the respondent bore the burden of proof. Defendant cites numerous reported cases in which AFR 36–2 type procedure was upheld, but none involved the combination we have here, a fact that supports our belief that the situation was and is unusual if not rare. At any rate, we assume defendant will make its interpretation of AFR 36–2 known to future Boards and that they will require the Air Force to bear the burden of proof at least wherever a stigma-type discharge is under serious consideration.

Defendant says AFR 36–2 accords to reservists rights granted by statute only to regulars, an advantage to them. However, we concluded, with support in the Manual, that a regular officer cannot legally receive a stigma-type discharge after mere administrative proceedings of any kind, and in this regard AFR 36–2 show cause procedure does not and cannot treat regulars and reservists alike.

Accordingly, we affirm our judgment and deny defendant's motion to the extent it seeks dismissal of the petition, while allowing it to the extent of the revisions in our opinion above stated.

Plaintiff's corresponding motion raises no issue of substance and it is hereby denied.

Both parties have also moved for rehearing *en banc*. Upon consideration of said motions by all the active judges of the court, a majority having voted against such rehearing *en banc*, both of said motions are denied.

518 F. 2d 579

# GOOSE CREEK HUNTING CLUB, INC. v. THE UNITED STATES

[No. 11-73. Decided June 25, 1975]

ON THE PROOFS

**Eminent domain; taking; flood damage.**—Plaintiff asserts a claim for the alleged taking by the Government of a permanent flowage easement over appproximately 110 acres of land adjacent to Goose Creek in Louisiana, the land consisting of strips extending outward from the well-defined banks of the creek to an imaginary line where plaintiff's property reaches the elevation of 34 feet above mean sea level (m.s.l.). Goose Creek empties into the Boeuf River, a navigable stream, and the Boeuf River empties into the Ouachita River, also navigable. While the 110 acres, part of a larger parcel acquired in June 1971 by plaintiff, were used during the dry season (June-December) for hunting and cattle grazing, said acreage has never been usable during the wet season, being subject to intermittent flooding from Goose Creek. During the dry season the water in the creek was about 1½ feet deep and was at the elevation of about 24 feet m.s.l., and the area between the creek banks and the 34-foot m.s.l. line was covered with good grass. During the wet season the 110 acres below 34 feet m.s.l. have generally been covered with water, although the growth of certain commercially valuable trees had not been hindered. Since March 28, 1972 the 110 acres have been permanently flooded, resulting from construction by the Government of the Jonesville Lock and Dam as part of the Ouachita-Black Rivers Navigation Project (74 Stat. 480). It is *held* (1) that there is no evidence in the record justifying a finding of the navigability of Goose Creek or that it was ever used as a highway for water trade or travel; (2) that the 110 acres in issue are not subject to the Government's navigational servitude covering the beds of the navigable Ouachita and Boeuf Rivers, since such land is situated beyond the beds of those rivers and constituted fast land; and (3) that on March 28, 1972 defendant took a permanent flowage easement over the portions of plaintiff's property adjacent to Goose Creek situated below the 34-foot m.s.l. line and which extend from that line to the banks of the creek, comprising a total of approximately 110 acres, and is liable to plaintiff for the damages sustained. Plaintiff is entitled to recover and judgment is entered for plaintiff with the amount of recovery to be determined under Rule 131(c).

**Constitutional law; Congress, powers of; commerce, regulation of; navigable waters, rights of Government in.**

[1] A navigable stream is subject to the power that is vested in the

Federal Government by the Commerce Clause of the Constitution, Art. I, § 8, cl. 3.

Navigable Waters 🔑 2

**Evidence; weight and sufficiency of; uncontroverted evidence.**

[2] An authorization by Congress for improvements in a river in aid of navigation, by implication, amounts to a determination by Congress concerning the navigability of the river. Absent conflicting evidence, this court will accept such determination as evidence of actual use of the river as a highway for commerce in its ordinary condition.

Navigable Waters 🔑 1(2)

**Waters and watercourses; navigability; evidence of.**

[3] A stream is navigable if, in its ordinary condition, trade and travel are, or may be, conducted over it in the customary modes of trade and travel on water.

Navigable Waters 🔑 1(3)

**Waters and watercourses; navigability; burden of proof.**

[4] The burden of proof as to the navigability of a stream rests upon the party asserting it.

Navigable Waters 🔑 1(7)

**Eminent domain; nature and extent of power of Government; waters and watercourses.**

[5] Since the Federal Government has the power to improve navigable waters in the interest of navigation, if such improvement on a navigable stream raises its water level and thereby damages privately owned property situated within the stream bed, the Government is not liable for the ensuing damages, since such property is always subject to the Government's dominant servitude in the interest of navigation. Such servitude extends to the ordinary high-water mark on either side of a navigable stream.

Eminent Domain 🔑 2(10)

**Eminent domain; nature and extent of power of Government; waters and watercourses.**

[6] The Government's navigational servitude does not extend beyond the beds of navigable streams. If an action taken by the Government to improve the navigability of a navigable stream raises the water level in the stream and thereby causes it to overflow or otherwise damage property situated outside the stream bed, the Government is liable for the ensuing damages.

Eminent Domain 🔑 2(10)

**Waters and watercourses; high-water mark.**

[7] The bed of a navigable stream extends to the ordinary high-water mark on either side of the stream. The ordinary high-water mark is variously defined, e.g., as the line where the water stands sufficiently long to destroy vegetation below it; or as the line below

which the soil is so usually covered by water that it is wrested from vegetation and its value for agricultural purposes destroyed; or as the line below which the waters have so visibly asserted their dominion that terrestrial plant life ceases to grow and its value for agricultural purposes is destroyed; or as the line below which the soil is kept practically bare of vegetation by the wash of the waters of the river from year to year in their onward course.

Navigable Waters ⚷ 1(3)

*William D. Brown*, attorney of record, for plaintiff. *Brown & Wicker*, of counsel.

*John H. Germeraad*, with whom was *Assistant Attorney General Wallace H. Johnson*, for defendant.

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

PER CURIAM: This case comes before the court on plaintiff's motion, filed March 21, 1975, for judgment pursuant to Rule 141(b), requesting that the court adopt, as the basis for its judgment in this case, the recommended decision of Senior Trial Judge Mastin G. White, filed December 11, 1974, pursuant to Rule 134(h), defendant having filed no notice of intention to except thereto and the time for so filing having expired. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth,* it hereby grants plaintiff's motion and adopts the decision as the basis for its judgment in this case. Therefore, plaintiff is entitled to recover and judgment is entered for plaintiff, with the amount of recovery to be determined pursuant to Rule 131(c).

### OPINION OF TRIAL JUDGE

WHITE, *Senior Trial Judge:* The plaintiff asserts in this case a claim against the defendant for the alleged taking by the Government of a permanent flowage easement over approximately 110 acres of land in a much larger parcel of unimproved land, containing a total of 1,119.10 acres, owned by the plaintiff and situated in Franklin Parish, Louisiana. The 110 acres directly involved in the present litigation consist of strips of land which are adjacent to a stream known as Goose Creek and which extend outward from the banks of the creek on either side to an imaginary line where the plaintiff's property reaches the elevation of 34 feet above mean sea level ("m.s.l.").

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*Whereas the court adopts the trial judge's separate findings of fact, which are set forth in his report filed December 11, 1974, they are not printed herein since such facts as are necessary to the decision are contained in his opinion

It is my opinion that the plaintiff is entitled to recover.

The plaintiff is a Louisiana corporation. As its name indicates, the plaintiff was organized, and it is operated, principally as a hunting club. The plaintiff acquired the parcel of unimproved land previously mentioned, containing 1,119.10 acres, on June 28, 1971. The property was acquired primarily for use in the hunting of deer, wild turkey, doves, and other game.

Goose Creek, which flows generally from north to south, traverses the plaintiff's property and then empties into the Boeuf River at the southern boundary of the property.

The part of Louisiana in which the plaintiff's property is located has a dry season and a wet season. The dry season generally begins in the latter part of June and continues until the latter part of December, while the wet season generally begins in the latter part of December and continues until the latter part of June.

Prior to the events which gave rise to the present litigation, the 110 acres adjacent to Goose Creek that are involved in the present suit could be, and were, used by the plaintiff during the dry season each year for hunting. In addition, the 110 acres were suitable for the grazing of cattle during the dry season. This portion of the property had long been used for such purpose during the dry season each year prior to the acquisition of the property by the plaintiff, and the cattle grazing continued after the plaintiff acquired the property, up until the happening of the events which led to the institution of the present suit. Also, the 110 acres contained some bottom-land types of trees having commercial value.

Goose Creek during the dry season was formerly a small stream in the portion of the plaintiff's property with which the court is concerned. It varied in width from about 8 feet to 10 or 12 feet, except that it was about 40 feet wide near its mouth. There were well-defined banks on either side of the stream bed. During the dry season, the water in the creek was about 1½ feet deep and was at the elevation of about 24 feet m.s.l., on the average, and the banks of the stream extended upward from the water level to a height that varied from approximately 1 foot to approximately 18 inches.

Extending outward from the creek banks on either side, the ground is almost flat and slopes upward very gradually. The strips of land adjacent to Goose Creek on either side, lying between the creek banks and the imaginary line where the land reaches the elevation of 34 feet m.s.l., and comprising a total of approximately 110 acres, were formerly covered with good grass during the dry season. These strips of land also contained a few willow trees alongside the creek and some bitter pecan and overcup oak trees. The growths of bitter pecan and overcup oak trees generally began at a distance somewhere between 10 yards and 50 yards from the creek banks, so that the spaces closest to the creek were formerly, during the dry season, grassy meadows without trees, except for a few willows alongside the creek. As previously indicated, the 110 acres could formerly be used, and were used, during the dry season for hunting and for the grazing of cattle. Also, the trees there had commercial value.

The 110 acres of land directly involved in the present litigation have never been usable by the plaintiff during the wet season, even prior to the events which gave rise to the present litigation. The plaintiff's property, up to an elevation substantially beyond the 34-foot m.s.l. line marking the outer boundary of the 110 acres, has always been subject to intermittent flooding from Goose Creek during the wet season, and the 110 acres lying below the 34-foot m.s.l. line have generally been covered with water for months at a time each year during the wet season. However, such overflow conditions have not prevented the growth on the 110 acres of some willow, bitter pecan, and overcup oak trees, or the growth of good grass during the dry season, after the disappearance of the overflow waters.

For the 110 acres of land directly involved in this litigation, the annual cycle of being dry part of the year and covered with water part of the year ended on March 28, 1972.

Since that date, the 110 acres have been permanently flooded. The permanent flooding resulted from the construction by the Government, near Jonesville, Louisiana, of a dam and appurtenant lock as part of a major program for the improvement of navigation on the Ouachita-Black river system.

As indicated earlier in this opinion, Goose Creek, after traversing the plaintiff's property from north to south, empties into the Boeuf River at the southern boundary of the property. Approximately 8 miles (in a straight line) downstream from the point where Goose Creek empties into the Boeuf River, the latter empties into the Ouachita River. Then, at Jonesville, Louisiana, which is located approximately 16 miles (in a straight line) downstream from the point where the Boeuf River empties into the Ouachita River, the Ouachita River is joined by the Tensas River and the Little River, and the three streams combine to form the Black River. The Black River empties into the Red River, which, in turn, empties into the Mississippi River.

In the River and Harbor Act of July 14, 1960 (74 Stat. 480, 481), as amended and supplemented, Congress authorized (among other things) a large-scale program for the improvement of navigation on the Ouachita-Black river system, in order to provide a navigation channel at least 9 feet deep and 100 feet wide extending from the mouth of the Black River to Camden, Arkansas, on the Ouachita River. This involved, *inter alia*, the construction of a dam and appurtenant lock near Jonesville, Louisiana.

It is clear from the evidence, as summarized in the findings of fact, that the Ouachita River is a navigable water of the United States. It was used for steamboat traffic long before any channel-deepening or other improvements were made in the river pursuant to congressional authorizations. As the Ouachita River, in its ordinary condition, was susceptible of being used, and was actually used, as a highway for commerce, it is a navigable stream and is subject to the power that is vested in the Federal Government by the commerce clause of the Constitution (art. I, § 8, cl. 3). *The Daniel Ball*, 77 U.S. (10 Wall.) 557, 563 (1870). The River and Harbor Act of 1960 was enacted pursuant to this power.

The Jonesville dam-and-lock combination was duly constructed pursuant to the authorization in the River and Harbor Act of 1960, and was placed in operation on March 28, 1972. It created in the Ouachita River a pool which is commonly referred to as the Jonesville Pool and which extends upstream approximately 107 miles to Columbia, Louisiana. In order to provide a navigation channel at least 9 feet deep and 100 feet wide at all points, as provided for in the River and Harbor Act of 1960, the water in the Jonesville Pool is at all times maintained at a minimum elevation of 34 feet m.s.l.

The Boeuf River empties into the Jonesville Pool of the Ouachita River. Because of the elevation of the Jonesville Pool, the water in the Boeuf River, and in its tributary, Goose Creek, has been maintained at a minimum elevation of 34 feet m.s.l. at all times since March 28, 1972. This has resulted in the permanent flooding of the plaintiff's property adjacent to Goose Creek up to the elevation of 34 feet m.s.l., and has permanently deprived the plaintiff of the use of approximately110 acres of land during the dry season each year for hunting and for the grazing of cattle. In addition, the willow, bitter pecan, and overcup oak trees standing in the permanently flooded area will ultimately be destroyed. These types of trees, which have commercial value but are not as valuable as upland timber, will grow on bottom land which is subject to intermittent flooding, including land which is covered with water for months at a time each year, provided such land is also free of water for at least an approximately equivalent amount of time each year. However, such trees will not survive on land that is permanently flooded.

As previously noted in this opinion, the permanent flooding of 110 acres of the plaintiff's property adjacent to Goose Creek resulted from the Government's action in raising the minimum level of the water in the Ouachita River, a navigable stream, for the purpose of improving navigation in that river, and this, in turn, raised the minimum level of the water in, first, the Boeuf River, a tributary of the Ouachita, and, second, in Goose Creek, a tributary of the Boeuf. From Goose Creek, the water spread out permanently over the plaintiff's property up to the 34-foot m.s.l. line.

Although the record does not contain any evidence regarding the actual use of the Boeuf River as a highway for commerce in its ordinary condition, there is evidence in the record indicating that Congress, in the 1880's, authorized certain improvements to be made on the Boeuf River in aid of navigation. This, by implication, amounted to a determination by the Congress concerning the navigability of the Boeuf River. Such determination must be accepted for the purposes of the present litigation, in the absence of any conflicting evidence.

On the other hand, there is no evidence in the record that would justify a finding of navigability with respect to Goose Creek. A stream is navigable if, in its ordinary condition, trade and travel are, or may be, conducted over it in the customary modes of trade and travel on water. *The Daniel Ball*, *supra*, 77 U.S. (10 Wall.) at 563. The record in this case is wholly devoid of evidence indicating that Goose Creek was ever used as a highway for commerce in its ordinary condition. Furthermore, the circumstance that, prior to the establishment of the Jonesville Pool in the Ouachita River, the creek was quite narrow at most places and the water in the creek was only about 1½ feet deep, on the average, during the dry season of approximately 6 months each year would militate against an affirmative determination as to the navigability of Goose Creek in its ordinary condition.

The defendant says in its brief that Goose Creek should be regarded as a navigable stream, but the defendant did not, at the trial of the case, present any evidence upon which to base such a contention. The burden of proof as to the navigability of a stream rests upon the party asserting it. *Iowa-Wisconsin Bridge Co.* v. *United States*, 114 Ct. Cl. 464, 509, 84 F. Supp. 852, 867 (1949), *cert. denied*, 339 U.S. 982 (1950). Accordingly, Goose Creek must be regarded as a nonnavigable stream for the purposes of the present case.

Under the commerce clause of the Constitution, the Federal Government has the power to improve navigable waters in the interest of navigation; and if such an improvement on a navigable stream raises the water level in the stream and thereby damages privately owned property situated within the bed of the stream, the Government is not liable for the ensuing damages. *United States* v. *Chicago*, *Milwaukee*, *St.*

*Paul & Pacific R.R.*, 312 U.S. 592, 596 (1941); see *United States* v. *Kansas City Life Insurance Co.*, 339 U.S. 799, 804 (1950). This is because privately owned property situated within the bed of a navigable stream is always subject to the Government's dominant servitude in the interest of navigation. *United States* v. *Willow River Power Co.*, 324 U.S. 499, 509 (1945).

The bed of a navigable stream is bounded by—and, therefore, the navigational servitude of the Government extends to—the ordinary high-water mark on either side of the stream. *United States* v. *Willow River Power Co.*, *supra*, 324 U.S. at 509.

On the other hand, the navigational servitude of the Government does not extend beyond the beds of navigable streams; and if an action taken by the Government to improve the navigability of a navigable stream raises the water level in the stream and thereby causes it to overflow or otherwise damage property situated outside the bed of such stream, the Government is liable for the ensuing damages. *United States* v. *Kansas City Life Insurance Co.*, *supra*, 339 U.S. at 806–8.

It necessarily follows that the 110-acre portion of the plaintiff's property under consideration here is not subject to the Government's navigational servitude covering the beds of the navigable Ouachita and Boeuf Rivers, since such land is situated beyond the beds of those rivers. It also follows that the Government is liable for the permanent flooding of the 110 acres as a result of the Government's program for the improvement of navigation on the Ouachita River.

Perhaps it should be noted that although the 110 acres involved in this litigation are adjacent to Goose Creek, they are situated beyond the bed of the creek. As stated earlier in this opinion, the bed of a stream is the area lying below the ordinary high-water mark on either side of the stream. Judicial decisions indicate that the ordinary high-water mark can be variously defined—*e.g.*, as the line where the water stands sufficiently long to destroy vegetation below it (*Kelley's Creek and Northwestern R.R.* v. *United States*, 100 Ct. Cl. 396, 406 (1943)); or as the line below which the soil is so usually covered by water that it is wrested from vegetation and its value for agricultural purposes destroyed (*Harrison* v. *Fite*, 148 Fed. 781, 783 (8th Cir. 1906)); or as the line below which the waters have so visibly asserted their dominion that terrestrial plant life ceases to grow and, therefore, the value for agricultural purposes is destroyed (*Borough of Ford City* v. *United States*, 345 F. 2d 645, 648 (3rd Cir. 1965), *cert. denied*, 382 U.S. 902); or as the line below which the soil is kept practically bare of vegetation by the wash of the waters of the river from year to year in their onward course (*State of Oklahoma* v. *State of Texas*, 260 U.S. 606, 632 (1923)).

Under any of the definitions mentioned in the preceding paragraph, the strips of land adjacent to Goose Creek that are involved in this case must necessarily be regarded as lying above the ordinary high-water mark of Goose Creek. These strips of land, before they were permanently flooded as a result of the Government's action, were covered with good grass during the dry season each year and they contained a few willow trees and some bitter pecan and overcup oak trees—all of which were species of terrestrial, rather than aquatic, plant life. Furthermore, these strips of land were suitable for use during the dry season, and they were actually used, for the grazing of cattle, an agricultural purpose. Therefore, the strips of land involved in this case constituted fast lands rather than part of the bed of Goose Creek; and they would not have been subject to the navigational servitude of the Government even if Goose Creek had been a navigable stream.

For the reasons previously stated in this opinion, the defendant is liable to the plaintiff for the damages sustained by the latter as a result of the permanent flooding of approximately 110 acres of the plaintiff's property adjacent to Goose Creek. As the initial trial was held on the issue of liability only, it will be necessary to determine the amount of the plaintiff's recovery in subsequent proceedings under Rule 131(c).

It might be appropriate to mention, before concluding this opinion, that although the portion of the plaintiff's property above the elevation of 34 feet m.s.l. has not been adversely affected up to the present time by the construction of the Jonesville dam and lock and the establishment of the Jonesville Pool in the Ouachita River, the evidence in the record indicates that the portions of the plaintiff's property lying between the 34-foot m.s.l. line and about the 37-foot m.s.l. line, comprising a total of approximately 49 acres, will probably be permanently damaged hereafter as a result of the permanent flooding of the portions of the property lying below the 34-foot m.s.l. line.

### CONCLUSION OF LAW

Upon the findings of fact and the foregoing opinion, which are adopted by the court and made a part of the judgment herein, the court concludes as a matter of law that the plaintiff is entitled to recover, and judgment is entered to that effect. The amount of the recovery will be determined in subsequent proceedings under Rule 131(c).

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518 F. 2d 584

## RUTH CHRISTIE v. THE UNITED STATES

[No. 486-73. Decided July 11, 1975]*

### ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; resignation; voluntariness of resignation.**—Plaintiff, a former GS-13 employee of the Navy Department, seeks back pay, reinstatement and other relief. On November 22, 1971 plaintiff was issued notice of proposed removal for attempting to inflict bodily injury to her supervisor. She denied the charge in writing, and on February 23, 1972 she was notified by letter of the agency's decision to separate her for cause. Since the installation was undergoing reduction-in-force, the effective date of her discharge was extended to March 3, 1972 to give her opportunity to explore the alternative of voluntary resignation via discontinued service retirement. Plaintiff attempted to submit a resignation conditioned by her allegation that it was tendered under duress, but upon being advised that applicable regulations mandate that such resignations be voluntary, she tendered a protest-free resignation and an application for discontinued service retirement, effective March 10, 1972. Subsequently, she appealed to the Appeals Examining Office (AEO) of the Civil

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*Plaintiff's motion for rehearing and suggestion for rehearing *en banc* were denied October 10, 1975. Judge Skelton would allow plaintiff's suggestion for rehearing *en banc* and plaintiff's motion for rehearing.

Service Commission (CSC), contending that her resignation was involuntary and requesting a hearing. AEO held the separation by resignation was voluntary and denied the request for a hearing, stating that voluntary separations are not within CSC's appellate jurisdiction. This decision was affirmed by CSC Board of Appeals and Review. The issue before the court is whether plaintiff was wrongfully separated from Government service by means of a coerced resignation. It is *held* that, as a matter of law, plaintiff's resignation was voluntary, and as such CSC properly denied her hearing request. Defendant's motion for summary judgment is granted, plaintiff's cross-motion is denied, and the petition is dismissed.

**Civilian pay; resignation; duress; what constitutes.**

[1] Voluntariness of a resignation is vitiated only when the resignation is submitted under duress brought on by Government action. The elements constituting duress are (1) that one side involuntarily accepted the terms of another, (2) that circumstances permitted no other alternative, and (3) that said circumstances were the result of coercive acts of the opposite party.

U S 🔑 36

**Civilian pay; resignation; presumption of voluntariness.**

[2] Government employee resignations are presumed to be voluntary. This presumption will prevail unless the employee comes forward with such sufficient evidence to establish that the resignation was involuntarily extracted.

U S 🔑 36

**Civilian pay; administrative remedies; failure to exhaust; generally.**

[3] Since plaintiff had the opportunity before the Civil Service Commission to rebut the presumption that employee resignations are voluntary but failed to do so in her case, the doctrine of exhaustion of administrative remedies restricts this court's review of the present civilian employment action to the factual matters preserved for its consideration.

Courts 🔑 460

**Civilian pay; resignation; voluntariness; generally.**

[4] In determining a claim of resignation under duress, duress is not measured by the employee's subjective evaluation of a situation; rather the test is an objective one. Merely because plaintiff was faced with an inherently unpleasant situation, in that her choice was arguably limited to resignation with discontinued service retirement or to challenge of the validity of her proposed discharge for cause, does not obviate the voluntariness of her resignation.

U S 🔑 36

**Civilian pay; resignation; duress, when under.**

[5] A threatened termination of federal employment must be for good cause in order to precipitate a binding, voluntary resignation.

Where plaintiff was presented with the choice of resigning or challenging the validity of her proposed discharge for cause, an admission by her of an incident which formed the basis of the proposed discharge is prima facie evidence that an arguable basis for the discharge against her existed and is fatal to her attempt to impeach the agency's decision to terminate her for cause.

U S 🔑 36

**Civilian pay; resignation; voluntariness; misrepresentation by agency.**

[6] While Civil Service Commission regulations recognize that a normally voluntary resignation is transformed into an involuntary one if obtained by agency misrepresentation, reliance on such misrepresentation is an essential element in an employee's claim of involuntary resignation.

U S 🔑 36

**Civilian pay; resignation; date of resignation.**

[7] An employee's signature to the necessary forms requesting separation from federal service and discontinued service retirement, ratifies the separation date contained therein and satisfies the requirement that the employee set her own effective resignation date.

U S 🔑 36

**Civilian pay; adverse personnel action; resignation, voluntary.**

[8] Voluntary separations are not adverse actions and are thus not appealable to the Civil Service Commission. (5 C.F.R. § 752–201 (b)).

U S 🔑 36

**Civilian pay; hearing; agency level hearing; right to hearing.**

[9] The legal classification of an employee's separation from federal service is determinative of entitlement to a hearing. While a nonprobationary federal employee has a property interest in her job, where she voluntarily relinquishes such interest the separation cannot be considered an adverse action instituted by the Government, and thus a hearing is not required.

U S 🔑 36

*Elsa R. Kaufman*, attorney of record, for plaintiff.

*Iraline G. Peniston*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before SKELTON, KUNZIG, and BENNETT, *Judges*.

KUNZIG, *Judge*, delivered the opinion of the court:

In this civilian employment action, the court is confronted with a single legal question: whether plaintiff was wrongfully separated from government service, by means of a coerced resignation. We hold that, as a matter of law, plaintiff's resignation was voluntary.

The factual setting in which this case arises may be briefly summarized as follows: Plaintiff, a 5-point veteran's preference employee, had continuously served in the Navy Department since 1943. From 1943 until August 1946, plaintiff was on active duty in the United States Naval reserve. At the end of World War II, she was converted to civilian status and remained a civilian employee until the effective date of her resignation, March 10, 1972. At the time of her separation, plaintiff was employed as a Technical Data Management Specialist, GS-13, with the Naval Weapons Engineering Support Activity, located at the Washington, D.C. Navy Yard.

On November 22, 1971, plaintiff was issued an Advance Notice of Proposed Removal for "Attempting to Inflict Bodily Injury to Your Supervisor—First Offense." This charge stemmed from an alleged striking incident during a meeting on November 15, 1971, where plaintiff allegedly made threatening gestures toward her supervisor. Plaintiff submitted a written reply denying the charge on December 8, 1971.

By letter dated February 23, 1972, plaintiff was notified of the agency's decision to separate her for cause, effective February 25, 1972. However, since the installation was undergoing a reduction-in-force (RIF), the effective date of plaintiff's discharge was extended to give her the opportunity to explore the alternative of voluntary resignation via Discontinued Service Retirement. While it is disputed as to which side initiated the extension request, the effective date of plaintiff's proposed removal was reset to March 3, 1972.

The period between February 25 and March 3, 1972 was marked by a series of exchanges between the agency and plaintiff. Plaintiff attempted to submit a resignation conditioned by her allegation that it was being tendered under duress. The agency informed plaintiff it could not accept such a conditional resignation because it was not "in consonance with the most current controlling regulation" and advised plaintiff that applicable regulations mandate that such resignations be voluntary. On March 3, 1972, plaintiff tendered a resignation free of protest and submitted an application for discontinued service retirement, both effective March 10, 1972. Plaintiff's resignation and application for discontinued service retirement were processed and approved by the agency and plaintiff was separated from the Navy Department effective March 10, 1972.

Subsequent to her resignation, plaintiff appealed to the Appeals Examining Office (AEO) of the Civil Service Commission (CSC). In her March 25, 1972 letter, plaintiff switched back to her earlier position that her resignation was involuntary, described its effect as an "adverse action" taken against her, and requested a hearing before the AEO. The AEO held, in a decision issued on June 12, 1972, that plaintiff's separation by resignation was voluntary. Stating that voluntary separations are not within the CSC's appellate jurisdiction, the AEO denied plaintiff's request for a hearing. The decision of the AEO was affirmed by the CSC Board of Appeals and Review (BAR) on December 8, 1972. Having exhausted her administrative remedies, plaintiff filed the present action in this court on December 19, 1973, seeking back pay, reinstatement and other relief.

This case, in its present posture, is before us on cross-motions for summary judgment. Defendant's motion is grounded on plaintiff's failure to establish by objective standards that her resignation was obtained by duress. Plaintiff's cross-motion for summary judgment is premised on the view that the totality of events surrounding her resignation evidences a denial of any viable choice but to resign and thus, as a matter of law, she is entitled to judgment. For the reasons stated below, we conclude that plaintiff's allegation of involuntary resignation fails as a matter of law and therefore dismiss the petition.

This court has enunciated a principle, now firmly established, for determining whether a resignation is voluntarily tendered. The element of voluntariness is vitiated only when the resignation is submitted under duress brought on by

Government action. *Leone* v. *United States*, 204 Ct. Cl. 334, 339 (1974). The tripart test for such duress is:

> * * * (1) that one side involuntarily accepted the terms of another; (2) that circumstances permitted no other alternative; and (3) that said circumstances were the the result of coercive acts of the opposite party. * * * *Fruhauf Southwest Garment Co.* v. *United States*, 126 Ct. Cl. 51, 62, 111 F. Supp. 945, 951 (1953).

Employee resignations are presumed to be voluntary. This presumption will prevail unless plaintiff comes forward with sufficient evidence to establish that the resignation was involuntarily extracted. Plantiff had the opportunity to rebut this presumption before the CSC. This court, under the doctrine of exhaustion of administrative remedies, must restrict its review to the factual matters presented below. *See Haynes* v. *United States*, 190 Ct. Cl. 9, 12–13, 418 F. 2d 1380, 1383 (1969).

Upon review of the facts as they appear in the record before the CSC, it is clear that plaintiff has failed to show that her resignation was obtained by external coercion or duress. Duress is not measured by the employee's subjective evaluation of a situation. Rather, the test is an objective one. *McGucken* v. *United States*, 187 Ct. Cl. 284, 289, 407 F. 2d 1349, 1351, *cert. denied*, 396 U.S. 894 (1969); *Pitt* v. *United States*, 190 Ct. Cl. 506, 513, 420 F. 2d 1028, 1032 (1970). While it is possible plaintiff, herself, perceived no viable alternative but to tender her resignation, the record evidence supports CSC's finding that plaintiff chose to resign and accept discontinued service retirement rather than challenge the validity of her proposed discharge for cause. The fact remains, plaintiff *had a choice*. She could stand pat and fight. She chose not to. Merely because plaintiff was faced with an inherently unpleasant situation in that her choice was arguably limited to two unpleasant alternatives does not obviate the voluntariness of her resignation. Federal Personnel Manual Supp. 752–1, subchapter S1–2a(3).

This court has repeatedly upheld the voluntariness of resignations where they were submitted to avoid threatened termination for cause. *Pitt* v. *United States*, *supra* (termination resulting from possible criminal prosecution); *Cosby* v.

*United States*, 189 Ct. Cl. 528, 417 F. 2d 1345 (1969) (termination for gross insubordination); *Autera* v. *United States*, 182 Ct. Cl. 495, 389 F. 2d 815 (1968) (termination for incompetence). Of course, the threatened termination must be for good cause in order to precipitate a binding, voluntary resignation. *Autera* v. *United States*, *supra* at 499, 389 F. 2d at 817. But this "good cause "requirement is met as long as plaintiff fails to show that the agency knew or believed that the proposed termination could not be substantiated. *Leone* v. *United States*, *supra* at 340. Although plaintiff has attempted to impugn the agency's motivation for proceeding with her proposed termination, plaintiff does not deny that the incident which formed the basis of the charge against her had taken place (although she does assert the so-called assault was nothing more than an "inadvertent touching"). This admission is fatal to plaintiff's attempt to impeach the agency's decision to terminate her for cause. Whether this charge could have been sustained had plaintiff chosen to appeal her discharge for cause is irrelevant. What is relevant is that the admission of this incident is prima facie evidence that an arguable basis for discharge existed.

Plaintiff's suggestion that her resignation was obtained as a result of agency deception is completely unsupported by the record. It is true that CSC regulations recognize that a normally voluntary action is transformed into an involuntary one if obtained by agency misrepresentation. Federal Personnel Manual Supp. 752–1, subchapter S1–2a(1). But reliance on the misrepresentation is an essential element. Here, plaintiff not only fails to show such reliance, her own words completely repudiate it. In her request for consideration to the CSC AEO, dated March 25, 1972, plaintiff did allege that the agency misrepresented the consequences of a dismissal for cause regarding retirement/annuity rights. But in the same sentence, plaintiff concedes that the alleged misrepresentations were corrected "in later explorations of alternatives" before she submitted her disputed resignation. This concession clearly negates any suggestion that plaintiff relied on any purported agency misrepresentations.

Plaintiff's argument that her separation should be voided because she was not permitted to set the effective date of her resignation has no merit. When plaintiff signed the necessary forms requesting her separation from the rolls and her request for discontinued service retirement, she adopted the date contained therein as her own. This ratification, signified by her signature, clearly satisfies the requirements that plaintiff set her own effective date of resignation.

Since plaintiff has failed to present an adequate claim of coerced resignation, CSC properly declined to accept her appeal. Voluntary separations are not adverse actions and are thus not appealable to the CSC. *See* 5 C.F.R. § 752–201(b).

At oral argument, plaintiff's counsel raised the issue of whether CSC's denial of a requested hearing compels reinstatement. Our answer is that it does not.

It would be folly to suggest that any time a hearing is requested, an agency must grant it. Yet, in effect, that is what plaintiff seems to imply. What plaintiff overlooks is that the legal classification of her separation is determinative of her entitlement to a hearing.

The Supreme Court has recognized that non-probationary Federal employees have a property interest in their jobs. *Arnett* v. *Kennedy*, 416 U.S. 13 (1974). As such, employees are entitled to a due process hearing if the Government initiates an adverse action to remove them. However, when an employee voluntarily relinquishes her property interest, her separation cannot be considered an adverse action. Since there was no adverse action in this case, a hearing is not required. *McGucken* v. *United States*, *supra* at 289, 407 F. 2d at 1352. The underlying rationale is that a Government-initiated removal (adverse action) is analogous to a "taking" of a property interest; an employee-initiated separation is not. *Compare Board of Regents* v. *Roth*, 408 U.S. 564 (1972) *with Perry* v. *Sindermann*, 408 U.S. 593 (1972). Since plaintiff voluntarily relinquished her property interest, the CSC correctly denied her hearing request.

In summary, we hold the CSC properly declined to accept plaintiff's appeal because, as a matter of law, her resignation was voluntary. We further conclude CSC's denial of plaintiff's hearing request was proper.

Accordingly, defendant's motion for summary judgment is granted, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed.

BENNETT, *Judge*, concurring:

I join in the opinion and conclusion of Judge Kunzig. In response to the dissent, however, I wish to add a few comments.

The dissent questions the substantiality of the charge against plaintiff upon which the proposed removal was based. The incident was described in the "Advanced Notice of Proposed Removal," as follows:

> (2) *Incident.* On 15 November 1971, at approximately 0900, you came into my office with an information list, to describe certain problems you had encountered while working with the Engineering Change Proposal (ECP) program. You explained that you receive information over the phone from AIR–01A6 on Monday morning, and then relay it, via phone, to NAVAIRTECHSERV FAC. You complained that this took up a great deal of your time. I stated that assuming that the girl in AIR–01A6 reads from a list, she could send the data direct to NAVAIRTECHSERVFAC over the telecopier, and they, in turn, could phone back a confirmation directly to AIR–01A6. You replied in a disgusted manner that the girl at AIR–01A6 had better things to do (or words to that effect). I stated that I would still like to know if she could do it, whereupon you stated "Well, I won't ask her" (or words to that effect), and proceeded to walk out. I said, "Ruth, I think you're being unreasonable." At that, you turned and approached where I was sitting at my desk. You stood over me and said in a somewhat strained voice, "You drive me nuts—you bastard, you're driving me nuts" (or words to that effect). At the same time, you swung at my face with your right hand doubled into a fist, which I stopped with my hands. I became quite concerned, not only for you and your apparant (sic) loss of self-control, but for my own physical safety as well. I asked, "What's wrong with you Ruth?" You just looked at me and attempted to pound me with your fists, perhaps five or six times. None of the blows hit my head or face, all fell on my hands and forearms with which I warded off the blows. Although these blows were not

> overly severe in nature, they were never-the-less, in my opinion, intended to inflict bodily harm to me. You then turned and left the office without uttering anything further. Mr. Harold Booher, Publications Presentation Methods Specialist, was in the office at the time and observed the incident, and more specifically, your actions immediately prior to leaving the room. I immediately turned to Mr. Booher and asked him to go see if you were all right. I indicated to him that I was worried about you, but that I was afraid that if I went in to see you personally, that it would only upset you more. Mr. Booher did go in and ask you if you were all right, to which you replied that you were.

Perhaps the notion of plaintiff's inflicting bodily injury on her male supervisor is not persuasive, but the striking of a supervisor in anger is surely intolerable in any employment relationship and is a valid basis for removal for cause whether the blows resulted in injury or not.

Furthermore, the incident was witnessed by a third party. Clearly, therefore, this is not a case in which the agency knew or believed that the proposed termination could not be substantiated.

Nor was the resignation the result of deception. In her appeal to the Civil Service Commission, plaintiff wrote:

> * * * The false information that removal for misconduct would result in sacrifice of all retirement/annuity rights was originally offered, *but was corrected in later exploration of alternatives.* [Emphasis supplied.]

Surely plaintiff cannot now be permitted to contradict that statement.

Finally, the dissent is mistaken in suggesting that defendant has admitted the allegations made by plaintiff, to wit, that the incident was contrived and that she was deceived, intimidated, and thereby coerced to resign. Defendant nowhere admits these allegations and, of course, makes no such admission by filing a motion for summary judgment as contrasted to a motion for dismissal. Defendant relies on the various documents in the record which show as a matter of law that plaintiff's resignation was voluntary. With regard to the affidavits filed with plaintiff's brief, defendant correctly notes that

> * * * the affidavits filed with plaintiff's brief should be disregarded to the extent they seek to raise new factual matters not presented to The Commission. Consideration of such new materials by this Court is barred by the doctrine requiring exhaustion of administrative remedies. *Haynes* v. *United States*, 190 Ct. Cl. 9, 12–13 (1969); *Pine* v. *United States*, 178 Ct. Cl. 146, 148, 371 F. 2d 466–68 (1967); *Long* v. *United States*, 148 Ct. Cl. 4, 9 (1960).

Plaintiff simply has no legal basis for recovery in this court on the facts properly before us on the motions.

SKELTON, Judge, dissenting:

I cannot agree with the decision of the majority because I believe that an injustice has been done in this case.

The sole question before the court is whether the plaintiff Ruth Christie voluntarily resigned her position with the Navy's Bureau of Aeronautics or whether the agency forced her to resign against her will by coercion, intimidation, and duress so as to make her resignation involuntary. I am firmly convinced that her resignation was coerced.

The plaintiff was a five-point veteran's preference eligible employee under the provisions of the Veterans' Preference Act of June 27, 1944, 58 Stat. 387, *as amended*, 5 U.S.C. §§ 1302, 2108, and 3309. She founded and organized the Bureau and headed it from 1944 to 1968. In 1968 a Mr. F. M. McNeal was made civilian head and in 1971 a Mr. A. J. McGuckin was made plaintiff's immediate supervisor. Neither man had had any prior experience in the work. The facts show that these two men began a course of harassing conduct toward the plaintiff to provoke her and to eventually get rid of her regardless of the means or the cost. From then on her doom was sealed, and it was only a question of time until a situation could be created on which charges could be brought against her. That opportunity came when McGuckin provoked her to anger and she inadvertently touched his shoulder with her fingers. As a result, plaintiff was charged with "attempting to inflict bodily injury on your supervisor."

Such a charge was ridiculous on its face. McGuckin was in about as much danger of bodily injury on that occasion as an elephant would be if touched by a gnat or a fly.

The harassing treatment the plaintiff received at the hands of McGuckin and McNeal was totally unjustified. Fellow employee Robert Clark said her treatment was "grossly unfair, if not illegal." Another employee, Richard Kreider, said the treatment Miss Christie received was "contemptuous," but that she "was very capable, had the respect of her fellow employees, and did nothing to warrant this treatment." He said further "this was a pure and simple case of sex discrimination." (She was the only woman employee, except clerks and secretaries.) Nevertheless, McGuckin and McNeal forced her out regardless of the cost. The time has now come for the cost to be paid.

The plaintiff alleges in this case that the charges arising out of the McGuckin incident were planned, contrived, and ridiculous, and that she had no intention of inflicting any bodily injury on McGuckin; that the charge was held over her head to force her to resign; and was not dismissed until after she resigned; that she was threatened with removal from her job on the charge and was told that if she was so removed she would forfeit all of her retirement benefits that she had earned with 29 years of service (which was of course a misrepresentation and false); that in any event she would be removed in a reduction-in-force program (which was false); and that she could sign a resignation form and still appeal her removal (which was false); and that her resignation was not voluntary but was induced by deceit, duress, intimidation, coercion and time pressure. The defendant filed a motion for summary judgment thereby admitting the foregoing allegations of the plaintiff to be true. Under these circumstances, there is no way that the Government is entitled to a summary judgment.

Faced with the above threats, deceitful and false misrepresentations, pressure, contrived charges, coercion, duress, intimidation, and time pressure, the plaintiff had no choice except to sign the resignation form. She was forced to choose on the one hand between what she believed to be the utter disaster of losing her job in disgrace along with her 29 year earned retirement annuity, and on the other hand a bare living on discontinued service retirement. She had a choice, as the poet says, between "death and exile," a choice between the "guillotine and the hangman's noose," a choice between "Scylla and Charybdis" (in avoiding one monster you fall prey to another. *See* Homer Od. XII. 73, 235, 430 and Gautier de Lille Alexandreis (circa 12).) It is clear that plaintiff had no choice except to sign the resignation form. The "freedom of choice" required by the regulations below was absent. Under these circumstances, plaintiff's resignation was not voluntary. Defendant's regulations so provide. The regulations are as follows:

> Federal Personnel Manual Supplement 752-1, Subchapter S1, Adverse Actions by Agencies (February 4, 1972).
>
> 2a(1) Separations and reductions in rank or pay voluntarily initiated by an employee are by their very nature actions which do not require the use of adverse action procedures. On the other hand, a normally voluntary action—i.e., *a resignation*, optional retirement, or reduction in rank or pay at the employee's request—*is an adverse action if it is obtained by duress, time pressure, intimidation, or deception.* Whether an action is voluntary or involuntary is determined not by the form of the action but the circumstances that produced it.
>
> (2) The Commission holds that an action requested by an employee *is voluntary only if the employee has freedom of choice.* The general principle is that an action is voluntary if the employee is free to choose, understands the transaction, is given a reasonable time to make his choice, and is permitted to set the effective date.
>
> (3) * * * [*I*]*f the agency uses deception, duress, time pressure or intimidation to force him to choose a particular course of action, the action is involuntary.*
>
> S1-2b. (4). Employee does not set effective date. *An action is involuntary if the employee does not set the effective date.* The agency may point out the desirability of another date, but it may not arbitrarily set an earlier or later date and have the action remain a voluntary one. [Emphasis supplied.]

These regulations plainly provide that:

> * * * [A] resignation * * * is an adverse action if it

> is obtained by duress, time pressure, intimidation, or deception. * * *

All of these elements are present in the instant case. Yet the majority holds that the resignation was voluntary. This is contrary to the facts.

Furthermore, the regulations provide that the resignation is voluntary:

> * * * [O]nly if the employee has freedom of choice. * * *

There was no freedom of choice in this case.

But there is more. The regulations provide:

> * * * [I]f the agency uses deception, duress, time pressure or intimidation to force him [her] to choose a particular course of action, the action is involuntary.

In the face of the Government's admission by the filing of its motion for summary judgment in this case that the agency used deception, duress, time pressure and intimidation to force the plaintiff to sign a resignation form, it is difficult to understand how the majority can hold that the resignation of the plaintiff was voluntary. Even without the Government's admission, the facts affirmatively show that her resignation was involuntary.

Under the circumstances pointed out above, the resignation form the plaintiff was forced to sign was an adverse action. Therefore, the agency was required to treat it as such and conduct an investigation and accord the plaintiff a hearing. Neither course was followed. The agency clearly violated its own regulations. This violation was made all the more evident by the fact that when the plaintiff signed the resignation form and delivered it to the agency she notified and advised the agency that she was signing the resignation because of coercion and duress by the agency. This information put the agency on notice of her coercion and duress claim, but it ignored these facts and denied the plaintiff the protection guaranteed to her by the regulations.

It should be pointed out that the agency violated its own regulations in another particular. The regulations quoted above provide that:

> * * * An action is involuntary if the employee does not set the effective date. [for retirement] * * * [B]ut it

> [the agency] may not arbitrarily set an earlier or later date and have the action remain a voluntary one.

In this case this regulation was clearly violated because the agency arbitrarily set three different dates for the resignation of plaintiff to become effective without consulting with the plaintiff as to the dates it selected and without allowing the plaintiff to "set the effective date." This was a direct violation of the regulations by the agency.

We have often held that a violation by an agency of its own regulations voids an action taken by it against an employee. Here we have not one but several of such violations.

The majority cites cases where we have held that resignations by employees were voluntary and that they were not entitled to any relief. However, a close examination of those cases show they are distinguishable on the facts. The Government anticipated such situations when it promulgated the regulations quoted above that provide that each case depends on its own facts, as follows:

> * * * Whether an action is voluntary or involuntary is determined not by the form of the action *but the circumstances that produced it.* [Emphasis supplied.]

Consequently the cases cited by the majority are not controlling here. The instant case is more like the facts in *Perlman* v. *United States*, 203 Ct. Cl. 397, 406–08, 490 F. 2d 928, 932–33 (1974) that the combination of the acts of the Government denied freedom of choice to the plaintiff as to his voluntary retirement.

The majority have undoubtedly been influenced by those resignation cases where we have denied relief, in which I joined, where the employee was guilty of overreaching or was attempting to gain an undue advantage by resigning. This is not such a case. The plaintiff was not guilty of any such overreaching nor was she trying to gain any extra benefits by resigning. On the other hand, she was bitterly opposed to resigning. She was merely trying to keep body and soul together. She was led to believe by the misrepresentations and coercion of the agency that the only way she could do this was by resigning. There was no way that she could profit or benefit by resigning. The overreaching and unconscionable conduct all occurred on the part of the agency. In short, she was forced out against her will. This sort of conduct should not be condoned, much less approved.

In this case the plaintiff requested a hearing on whether or not her retirement was voluntary (see affidavit of Mr. Carstater, her representative before the Commission, attached to her cross-motion for summary judgment and plaintiff's appeal letter of June 27, 1972). The Commission denied the hearing request, even though plaintiff pointed out that she was entitled to due process. This was clear error. *See Arnett* v. *Kennedy*, 416 U.S. 134 (1974) where the Supreme Court held in no uncertain terms that a Government job was property and that because of the due process clause it could not be taken from a Government employee without a hearing "at some stage of the proceeding." The decision of the Commission denying such a hearing in this case clearly violates the due process clause of the Constitution, and the opinion of the majority in approving this denial falls into the same error. See the following additional cases holding that property may not be taken from a citizen without a hearing: *Connell* v. *Higginbotham*, 403 U.S. 207 (1971) (loss of a state job); *Goldberg* v. *Kelly*, 397 U.S. 254 (1970) (loss of welfare payments); *Morrissey* v. *Brewer*, 408 U.S. 471 (1972) (revocation of a parole); *Wolff* v. *McDonnell*, 418 U.S. 539 (1974) (cancellation of a prisoner's good-time credits); *Bell* v. *Burson*, 402 U.S. 535 (1971) (cancellation of a driver's license); *Board of Regents* v. *Roth*, 408 U.S. 564 (1972) (damaged reputation and standing); *Sniadach* v. *Family Finance Corp.*, 395 U.S. 337 (1969) (garnishment of wages); *Fuentes* v. *Shevin*, 407 U.S. 67 (1972) (seizure of mortgaged property); and *Goss* v. *Lopez*, 419 U.S. 565 (1975) (suspension of school children).

It is obvious that the agency violated its own regulations in several respects; that the resignation of plaintiff was obtained by the agency through deceit, intimidation, misrepresentation, time pressure, duress and coercion (within the meaning of *Fruhauf Southwest Garment Co.* v. *United States*, 126 Ct. Cl. 51, 111 F. Supp. 945 (1953)); and that the agency denied the plaintiff due process as required by the Constitution in refusing to grant her a hearing as to the voluntariness of her resignation.

Accordingly, I would allow plaintiff's motion for summary judgment and enter judgment for the plaintiff, awarding her back pay plus other appropriate benefits and restoring her to her position, and I would deny defendant's motion for summary judgment. I would remand the case to the trial judge to determine the amount of plaintiff's recovery under Rule 131(c).

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518 F. 2d 594

# DYNALECTRON CORPORATION (PACIFIC DIVISION) v. UNITED STATES

[No. 414-69. Decided July 11, 1975]

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; default termination; defective specifications; multiple and distinct impossibilities of performance; partial waivers; breach; equitable adjustment.**—In December 1964 plaintiff entered into a fixed-price contract to supply for use on B-52 Air Force bombers 258 VHF jamming antennas (with options for an additional 449). From 58 firms solicited, plaintiff was sole bidder in response to an Invitation for Bids issued December 13, 1964. The contract called for First Article tests and test reports. On June 16, 1966 the contract was terminated for default, plaintiff having delivered only 25 antennas whose delivery was allowed prior to completion of the First Article testing. Development of the antenna began in 1960, the first contract being awarded to Tamar Electronics, Inc. which subsequently turned over its antenna to its wholly-owned subsidiary, Stoddart Aircraft Radio Co., and in 1964 the latter sold its rights in the antenna to plaintiff. The Air Force failed to keep the drawings current with the latest production model of the antenna so when plaintiff entered its bid the drawing showed a no-eyelet antenna whereas an antenna with eyelets was then in production, plaintiff initially assuming it would supply unchanged the Tamar antenna which the Air Force was then accepting. The IFB did not contain any actual test procedures. The unit control drawings specified, *inter alia*, temperature-altitude, vibration, shock, humidity, immersion (inconsistent with the requirement for eyelets), salt spray, and sand and dust tests. The specified physical length of the antenna was too short to comply with the electrical frequency and power requirements, the shape and size of the antenna was incompatible with the classified radiation pattern specifications, and the stress characteristics of the light-weight materials used did not meet the temperature, altitude (pressure), vibration and power-handling specifications. Although the Air Force was aware of these problems, the defective specifications were never corrected. Also, a significant factor in contract performance was the poor contract management of both parties, as well as other problems aggravated by the combination of bad specifications and poor management. Plaintiff seeks review under Wunderlich Act standards of that part of the decision by the Armed Services Board of Contract Appeals which denied its appeal from the default termination. It is held (1) that during performance plaintiff waived the eyelet defect, and the full immersion and antenna length problems, but did not waive the problems of temperature, altitude (pressure), vibration, shock power handling, coupled with the weight requirements. The circumstances indicate a situation of mutual fault. The court *agrees* with the trial judge that plaintiff did not recognize the full impossibility of the specifications until it had completed testing every alternative method of performance in May 1966, at which point it so informed the Air Force. All of the evidence points to the conclusion that neither plaintiff nor anyone else could perform the Air Force specifications without waivers; (2) that plaintiff was improperly defaulted and on the termination date it was entitled either to a convenience termination or to new specifications with the impossibilities eliminated and an extended completion date provided; (3) because of plaintiff's partial waiver and its poor contract management, it is not entitled to shift all of its losses to the Government. Plaintiff cannot have the termination converted to a convenience termination because of the contract language requiring that to obtain this relief, it must be without fault or negligence. Since the convenience-termination formula is precluded, except as a ceiling, the formula of shared costs as in a joint venture is applicable. The recommended decision of the trial judge is rejected, and the parties are to share equally the allowable and reasonable costs normally recoverable by a contractor in a convenience termination. Since this is a breach case, the cause is remanded to the trial division for quantum proceedings under Rule 131(c). The parties' motions for summary judgment are allowed in part and denied in part pursuant to this opinion, and judgment is entered for plaintiff to the extent called for in this opinion.

**Contracts; waiver; claim of impossibility of performance; defective specifications.**

[1] Waiver of impossibility of performance of a fixed-price supply contract because of defective specifications requires knowledge, and where various defects in specifications are independent causes of impossibility, knowledge of some defects is not knowledge of all, as where the contractor did not recognize the totality of impossibility of the specifications until it had completed testing every alternative method of performance under conditions in which deviations were not permitted, at which time it promptly so informed the contracting agency.

U S ⚿ 73(3)

**Contracts; performance; impossibility of performance.**

[2] The real test of impossibility of contract performance is whether the contract specifications require performance beyond the state of the art.

U S 🔑 73(1)

**Contracts; termination; default termination.**

[3] A default termination is the Government's way of telling the contractor that he has breached the contract. In a default termination the Government assumes the risk of having such termination converted to a convenience termination if it is wrong and if the contract so provided. Thus, where the Government insisted on its design specifications for performance of the subject fixed-price supply contract, despite notice of their deficiencies, it accepted the risk that they were non-performable, and in terminating the contractor for default the Government assumed the risk that the termination was not proper.

U S 🔑 72(11)

**Contracts; termination; default termination; defense.**

[4] It takes only one valid defense to void a default termination.

U S 🔑 72(7)

**Contracts; termination; default termination; mutual fault.**

[5] Where the Government-furnished specifications were defective but were never corrected despite notice from prior contractors and plaintiff of technical deficiencies, as well as including incompatible test requirements, and where plaintiff experienced multiple and distinct instances of impossibility excusing its performance, some of which it waived by failing to give notice and others of which it did not waive, a situation of mutual fault existed. Under the circumstances of this case, at the time plaintiff was default terminated it was entitled either to a convenience termination or to new specifications with the impossibilities eliminated and an extended completion date provided.

U S 🔑 72(7)

**Contracts termination; wrongful termination; mutual fault; equitable adjustment.**

[6] Where the parties were mutually at fault during contract performance and plaintiff's default termination was wrongful, still because of plaintiff's partial waiver of impossibility of performance, its deficient contract administration, and its repeated failure to point out the Government's errors, which if done, might have enabled the latter to minimize its own losses as well as the contractor's, it is inequitable to shift all the costs to the Government as in the normal convenience termination.

U S 🔑 72(11)

**Contracts; waiver; delay in asserting rights.**

[7] The waiver doctrine rests on the premise that a contractor's

delay in asserting its rights prejudices the Government by running up recoverable costs.

U S ⚷ 73(3)

**Contracts; termination; wrongful termination; mutual fault; equitable adjustment.**

[8] Where the parties were mutually at fault during contract performance, and the Government wrongfully default terminated the contract, whereas it could have limited its breach liability by a proper convenience termination, the contractor's fault does not bar it from breach recovery, with appropriate cost sharing. Since the convenience termination formula is ruled out, except as a ceiling, the formula of shared costs as in a joint venture is applicable. The Government retains liability for issuing defective specifications and the plaintiff retains liability for its contributory errors.

U S ⚷ 72(11)

**Contracts; mistake; mutual and unilateral mistakes.**

[9] The equitable powers of this court in actions at law are not limited to instances of mutual mistake in contract performance. They extend also to unilateral mistake when they are knowingly and unfairly exploited by the other side.

Courts ⚷ 460

*Roger N. Boyd*, attorney of record for plaintiff. *John P. Schelling*, and *Jones, Day, Reavis & Pogue*, of counsel.

*Michael J. Rubin*, with whom was *Assistant Attorney General Carla A. Hills*, for defendant.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge* and NICHOLS, *Judge*.

NICHOLS, *Judge*, delivered the opinion of the court:

Dynalectron Corporation (Pacific Division) seeks review of the decision of the Armed Services Board of Contract Appeals (ASBCA), 69-1 BCA ¶ 7595, affirming a default termination. This court earlier by order, 199 Ct. Cl. 996 (1972), refused to review the Board denial of excess reprocurement costs to the Government. We cited *S & E Contractors, Inc.* v. *United States*, 406 U.S. 1 (1972). As frequently happens in this type of case, a recommended decision of Trial Judge Harkins has become the focal point of the parties' adverse attention. However, under the law it is the Board decision we are reviewing. Trial Judge Harkins has aided us greatly by his able analysis but we reject his affirmance of the Board, which we find incompatible with his criticisms of the Board's conclusions and a misconstruction of the contract.

The subject matter of this case is a fixed price, supply contract for 258 Very High Frequency (VHF) jamming antennas for use on B-52 Air Force bombers as part of the AN/ALA-15 Electronic Countermeasures (ECM) system. Plaintiff's contract was awarded December 31, 1964, pursuant to a bid submitted on December 1, 1964, in response to an Invitation for Bids (IFB) issued on November 13, 1964. Plaintiff was the sole bidder from the 58 firms solicited. The contract called for "First Article" tests and test reports as well as an initial increment of 258 antennas (with options for an additional 449), each approximately $368.80 (minor variations in this price were negotiated during the life of the contract). The original contract involved $107,284.63, and each of the two supplemental orders added another $99,107.40, to the overall value of the procurement. The contract was terminated for default on June 16, 1966. Plaintiff had delivered only the 25 antennas whose delivery was allowed prior to completion of the First Article test program.

The original contract was twice formally amended: once on February 11, 1965, and a second time on December 20, 1965. It was the failure to have successful test data completed and available for Government review on January 3, 1966, as required by the December 20 agreement, that was the assigned cause for the default termination. The January 3 test data showed that plaintiff had not solved several critical engineering design problems, whose impossibility forms the basis for this appeal.

The standard for review is that of the Wunderlich Act, 68 Stat. 81, 41 U.S.C. §§ 321-22 (1970). Upon careful review of the Board's and trial judge's decisions and of the entire record, we agree with the trial judge that the Board's key factual finding of a waiver by contractor of all claims of contract impossibility is not supported by substantial evidence. Waiver requires knowledge, and the record is unconflicting that plaintiff (and defendant for that matter) did not realize the full impossibility of the defective specifications until May 1966, or about 18 months after the Board held plaintiff had full knowledge. We further observe the various defects in the specifications to be independent causes of impossibility with the result that knowledge of some defects is not knowledge of all.

Therefore since we agree with the trial judge that at least one cause of impossibility was not known or realized until May 1966, and that it was then promptly communicated to the Air Force, said impossibility was not waived and serves as an absolute bar to a default termination. On the other hand, plaintiff did waive, by not communicating, some of the other defects in the specifications, which defendant might, if notified, have corrected to its own as well as plaintiff's advantage.

By waiver in this case we mean that plaintiff, discovering some defects in the specifications, instead of refusing further effort at performance, as was its right (as even the Board admits), elected to treat what had been intended as a fixed-price production contract as if it were a Research and Development (R & D) project, experimenting with new techniques at its own sole expense, unless it were to succeed. If this had occurred as to all the defective specifications, plaintiff could not recover. But it did not.

## I

A chronology of this case follows:

1960–1964: Tamar Electronics, Inc., developed the original "Tamar Antenna" to meet the pure performance specifications of Exhibit WCLG–3B (an Air Force document prepared by a Wright-Patterson AFB engineer to govern all AN/ALA–15 system component procurement contracts, including the two types of antennas required on the ALA–15 system.) Tamar Electronics subsequently turned over its "Tamar Antenna" to its wholly owned subsidiary, Stoddart Aircraft Radio Company, Inc. And in 1964 Stoddart sold its rights in the "Tamar Antenna" to Dynalectron. During the lifetime of the three procurements from Tamar/Stoddart, the Air Force attached the Tamar/Stoddart antenna drawings to Exhibit WCLG–3B as design specifications (whereas previously WCLG–3B had only limited antenna size, weight, and shape to "good engineering practices.") The Air Force failed to keep the drawings attached to the exhibit current with the latest production model of the antenna so that by 1964 the drawings, *e.g.*, showed a "no-eyelet" antenna while an "eyelet" antenna was being produced and delivered.

Summer 1964: Stoddart Aircraft Radio Co. and the Air Force became embroiled in a default termination dispute because the Tamar antenna would not meet all of the WCLG-3B specifications; the Air Force backed down on the dispute and production of the Tamar antenna with eyelets continued.

August 1964: Dynalectron and Stoddart completed negotiations for sale of Tamar antenna line to Dynalectron.

November 1964: After the Air Force-Stoddart-Dynalectron negotiations to license further Tamar antenna procurement from Stoddart fell through, the Air Force issued its IFB. The IFB contained the defective specifications.

December 1, 1964: Dynalectron submitted only bid received by the Air Force. Bid letter noted intention to supply Tamar antenna with eyelets and to submit copies of prior test procedures for use with new contract. Bid letter also questioned what Air Force meant by "qualification tests" in IFB.

December 10, 1964: Dynalectron TWX accepted Air Force definition of "qualification tests" as synonymous with "engineering acceptance tests" and "preproduction tests."

December 21, 1964: Dynalectron received classified test data on Tamar antennas from Stoddart Aircraft Radio Co.

December 31, 1964: Dynalectron contract with Air Force was legally effective on this date.

Mid-January, 1965: Dynalectron completed review of classified test data received in December and became aware of some defects in the specifications.

February 11, 1965: First formal amendment to contract signed. Dynalectron agreed to non-eyelet antenna (new production process and design) and to new test procedures.

February 26, 1965: Other Air Force procurement officials issued unilateral incremental order for additional Dynalectron-Tamar antennas (delivery to be concurrent with delivery under original order).

March 2, 1965: Dynalectron protested unilateral incremental order as unreasonable in light of unexpected lengthy delay in Air Force approval of test procedures. Dynalectron was allowed and required to deliver only 25 antennas prior to completion of entire test procedure and testing program.

April 21, 1965: Dynalectron sent Air Force first of several notices about defective Government-furnished equipment (GFE), signal generator. Generator was a classified piece of test equipment available only from the Air Force.

April 29, 1965: Dynalectron sent Air Force first of several requests for Air Force to obtain extension of FCC frequency-authorization permit needed by Dynalectron to legally test Tamar antenna.

May 12, 1965: Dynalectron gave Air Force notice that introduction of crash safety test requirements into WCLG-3B test requirements was a change. In regard to the same test requirements, Dynalectron asked the Air Force to clarify which of two "last" tests was to be last—since both tests tended to destroy the test antenna and preclude further testing.

June 18, 1965: Dynalectron notified the Air Force that Air Force changes in test procedures would destroy Air Force signal generator—and that the risk of destruction was the Air Force's responsibility.

July 13, 1965: Even though the Air Force had not completed its review and approval of submitted test procedures, the Air Force threatened plaintiff with default termination for delays.

July 20, 1965: Dynalectron's response to Air Force threats of default termination blamed the delays on Air Force slowness in reviewing and approving test procedures and to substantial changes that the Air Force made in test procedure requirements. This default termination dispute was dropped by the Air Force after Dynalectron underwent a change in management.

August 18, 1965: Final approval of all test procedures was given to Dynalectron.

September 1, 1965: Dynalectron frequency-authorization permit expired without being renewed as requested by Dynalectron. Certain required electrical tests were illegal until a new permit issued.

September 8, 1965: Air Force was given full technical details of the initial-test failures of the Dynalectron-Tamar Antenna (which primarily was a failure to successfully pass the vibration test requirements). Dynalectron sought waivers of certain vibration test requirements.

September 1965: Air Force commenced procurement of twice-as-heavy and sturdier Adams-Russell antenna. Adams-Russell antenna for acceptability required waivers of all the design specifications in WCLG-3B (weight, shape, size).

October 28, 1965: Dynalectron sought change in test procedures to eliminate requirement that thermocouples be mounted on antenna during high-power radiation tests. The thermocouples burned up during the power tests, destroying the surrounding surface of the antenna (burning metal on a fiberglass-and-plastic surface is a bad combination).

November 24, 1965: The Air Force issued more default termination threats.

December 20, 1965: Air Force entered final signature on second and final formal amendment to contract. Contractor agreed to have test data available for Air Force review on January 3, 1966 (which was done). Contractor also agreed to complete testing by December 18, but this did not occur because of severe weather delays in testing during December.

January 3, 1966: Test data showed substantial failure of Volt-standing-wave-ratio (VSWR) requirements, vibration requirements and radiation pattern requirements. (Other minor discrepancies were also present.)

January 11, 1966: Air Force sent Dynalectron notice of a default-termination investigation.

March 14, 1966: Joint meeting between parties occurred. Record indicates that parties came away from meeting with different views of what had been accomplished. Air Force officials testified that plaintiff had accepted a 90-day time limit to complete its antenna or be defaulted. Plaintiff disputes this and says the Air Force authorized plaintiff to procure or make their own version of Adams-Russell single-blade antenna (with implicit waiver of WCLG-3B design specifications—just as with Adams-Russell). Dynalectron did in fact commerce its effort to build its own version of Adams-Russell antenna at this time, while continuing to try to solve design problems with Dynalectron-Tamar antenna. Air Force was timely notified of this new effort to comply with Air Force demands for antennas.

May 10–11, 1966: Another joint meeting occurred.

May 11, 1966: Air Force notified plaintiff in writing that all antenna work (on single-blade Adams-Russell type antenna) and all use of unapproved test procedures was at plaintiff's "own risk."

May 24, 1966: The Air Force trip report summarized situation:

(a) plaintiff had just failed power-handling test with latest Tamar-design antenna and was giving up Dynalectron-Tamar antenna effort as hopeless and impossible;

(b) plaintiff was proceeding on its version of a single-blade antenna, and asking an extension of time to July 25;

(c) the Air Force did not know whether this new effort would succeed; and

(d) the contracting officer recommended a default termination to his superiors in light of these facts.

June 16, 1966: Plaintiff was formally terminated for default.

July 1966: Plaintiff completed work successfully on a prototype single-blade antenna (similar to Adams-Russell).

## II

The following major problems afflicted this contract:

1. Bad specifications:

(a) The IFB in November 1964 included the entire WCLG-3B exhibit with out-of-date drawings attached—the drawings should have been those of the Tamar Antenna with eyelets then in production. Instead, the drawings were of earlier Tamar Antennas no longer in production or acceptable for delivery to the Air Force.

(b) The IFB did not show any of the many waivers and deviations to WCLG-3B granted to current and prior Tamar Antennas in order to be acceptable—no Tamar Antenna ever met all WCLG-3B specifications. Yet plaintiff initially assumed it would supply the Tamar Antenna which the Air Force was then accepting, unchanged.

(c) The IFB did not contain any actual test procedures, which (in addition to formal waivers) was another means the Air Force used to grant *de facto* waivers of WCLG-3B specifications.

(d) The contract was a collection of documents not readily found together (since several classified documents were included by reference). As a result it is doubtful that the entire collection ever received the type of engineering and legal review usually accorded Government contracts by the Air Force.

(e) Technical deficiencies occur in the specifications: WCLG-3B refers to "unit control drawings" to determine applicable tests for components obtained separately from the entire system. The unit control drawings for this particular antenna specify the (a) temperature-altitude, (b) vibration, (c) shock, (d) humidity, (e) immersion, (f) salt spray, and (g) sand and dust tests, as well as any other tests necessary to insure operation of the entire system. These test requirements of WCLG-3B were inconsistent with the production model of the Stoddart-Tamar Antenna with eyelets.

> (i) The eyelets were incompatible with the full immersion test which required an electrical performance test immediately after removing the immersed antenna from water. With a wet interior the antenna did not work properly—and the eyelets insured a wet interior.
>
> (ii) The specified physical length of the antenna was too short by about half an inch to comply with electrical (VSWR) frequency and power requirements of WCLG-3B.
>
> (iii) The shape and size of the antenna were incompatible with the classified radiation pattern specifications.
>
> (iv) The stress characteristics of the light-weight materials used did not meet the temperature, altitude (pressure), vibration, and power-handling specifications of WCLG-3B without waivers.

None of these problems were new to the Air Force, and the stringent test specifications had been added to WCLG-3B as an Air Force reaction to earlier antenna failures. Yet, even with prior notice from waivers asked for and granted and failed antennas, the Air Force never corrected or otherwise resolved these technical deficiencies in the specifications.

2. Poor contract management:

Both the Board and the trial judge noted poor contract management as a significant factor in this case.

On Dynalectron's side, several of the defects were noted in January 1965, but were not reduced to formal written notices to the Air Force until months later. The February 1965, amendment to the contract gives little hint of the technical problems discussed concurrently with extending the delivery schedule. This overly-cooperative attitude of plaintiff's working-level personnel with Air Force personnel de-

> layed substantially formal contract action on the key technical problems in this case.
>
> Similarly, on the Air Force side, 1.) geographical separation (Los Angeles officials were day-to-day administration delegates; Robins AFB, Georgia, officials were official procurement officers; and Wright-Patterson AFB, Ohio, officials made all the technical decisions including test procedures decisions and specification waivers), 2.) other work, and 3.) lack of technical expertise in certain key technical areas of the procurement (antenna production problems as opposed to system requirements and testing) precluded proper contract coordination and management. Everybody else deferred to Wright-Patterson AFB officials, and the Wright-Patterson AFB officials apparently never realized all the technical impossibilities built into their defective specifications. As a result, the specifications were never corrected.
>
> 3. Other problems:
>
> The combination of bad specifications and poor contract administration aggravated other problems. The 10-day test-procedure copying-exercise expanded into an eight-month project as the Air Force officials dictated many substantial changes in prior Stoddart-Tamar test procedures. The problem of the frequency-authorization permit (to broadcast test frequencies to test the electrical jamming capabilities of the antenna) went unresolved for months once the FCC and FAA discovered that the Tamar Antenna jammed commercial air-traffic-control frequencies in the Los Angeles area very effectively. The GFE signal generator broke down so many times and functioned so poorly, when operating, that an uncalculated amount of time was lost, yet the Air Force never provided a replacement. And the months of delay postponed a significant amount of testing into December 1965, when unusual snows followed by a sudden thaw accompanied with torrential rains caused some of the worst flooding ever in the West coast area. Plaintiff's test range sustained substantial damage and further delays to the program resulted.

## III

In regard to the claims of impossibility we come to the same conclusion that Trial Judge Harkins did—plaintiff waived the immersion problem and the antenna length problem, as impossibilities excusing performance deficiencies, but that plaintiff did not waive either the radiation patterns problem or the vibration test/weight-strength problem. (The vibration and power-handling test failures resulted from the inability of various combinations of light-weight materials to withstand the strength requirements of the vibration, temperature, pressure and power-handling test requirements.) This, as noted by both the Board and the trial judge, results in a situation of mutual fault.

But before discussing the legal effects of the parties' actions, it is necessary to review the facts (since the Board—despite its own contrary conclusions—concluded that plaintiff waived all of its impossibility claims in December 1964).

The waiver of the immersion problem was amply proved by Guy Nicholson's own testimony and the Dynalectron letter of July 20, 1965, in the Rule 4 File of the Board Record:

> In an effort to cooperate to the fullest extent possible, and after considerable negotiation and discussion, the accelerated schedule as set forth in Modification No. 1 [February 11, 1965, agreement] to the contract was concluded at no increase in cost to the Government. This despite our admonitions the antenna to be furnished, although resembling in outward appearance its predecessor, would have to be *considerably redesigned* [*without eyelets*] *to meet the upgraded requirements* of the Air Force. (Emphasis supplied.)

Similarly we find a waiver by failure to give notice or request a change order in regard to the VSWR antenna-length electrical frequency and power problem. At page 138 of the Board transcript, plaintiff's engineer Guy Nicholson testified that the classified test data (delivered December 21, 1964, and analyzed by mid-January 1965) clearly showed that:

> * * * The low power VSWR measured on the system did not meet the specification maximum of two frequencies, at two frequencies.

The Board (at 4–5 of its opinion) noted that:

> Dynalectron did not notify the Government concerning its discovery contemporaneously. * * *

Trial Judge Harkins (at 16 of his opinion) was even more pointed:

> * * * Plaintiff, moreover, did not ask for any deviations from the specifications, either those that applied to the -14A-1 or others, until May 12, 1966. [This statement overlooked September 1965, waiver requests.]

The record is also clear that Stoddart had had the same problem and sought a waiver—asking for longer length as in the original Boeing antenna and instead receiving a waiver of the electrical requirements and being told to keep the shorter length (the shorter length resulted in a smaller total exposed surface area of the antenna—a key factor in the aerodynamic stresses imposed on antenna and aircraft, and a factor which the Air Force determined outweighed the slight loss in electrical performance).

No adequate explanation is shown in the record for this failure to give the Air Force prompt notice of the defective specification as to antenna length incompatible with VSWR specifications.

However, as regards other technical deficiencies, the trial judge differed (at 23-24) with the Board:

> * * * Plaintiff, however, did not know that the "totality" of the specification was deficient until after failures in the vibration tests in September 1965, and in the power-handling test on May 16, 1966. Plaintiff acquired actual knowledge that the specification may have been deficient in its "totality" only after it had testing experience under conditions in which deviations were not permitted.

After carefully reviewing all the evidence, we agree with the trial judge that plaintiff did not recognize the full impossibility of the specifications until it had completed testing every alternative method of performance in May 1966, at which point it so informed the Air Force. We can cite no stronger evidence of this state of knowledge of plaintiff than plaintiff's own actions which fully accord with the trial judge's conclusion. Only in May 1966, after exhausting all alternatives to solve vibration/altitude-temperature/power-handling specifications, did plaintiff stop and tell the Air Force its specifications were defective.

We do not choose to discuss at length parties' semantic arguments over "deficient", "impossible" and "impractical". The real test, as we noted in *Foster Wheeler Corp.* v. *United States*, 206 Ct. Cl. 533, 545, 513 F. 2d 588, 594 (1975), is whether the specifications require: "performance beyond the state of the art * * *." The Board used concerning them the terms "deficient" and "impractical" to indicate that they thought performance was beyond the state of the art. There is no documentary evidence or expert testimony to indicate that the antenna-length (VSWR) and vibration/altitude-temperature/power-handling test specifications were within the then-defined state of the art. All of the evidence points to the single conclusion that neither plaintiff nor anyone else could perform the Air Force specifications without waivers).

## IV

The question that must now be asked is what legal conclusions are to be drawn from the foregoing facts.

The trial judge correctly distinguished certain cases where "impossibility" was held the contractor's risk: *Austin Co.* v. *United States*, 161 Ct. Cl. 76, 314 F. 2d 518, *cert. denied*, 375 U.S. 830 (1963); *Bethlehem Corp.* v. *United States*, 199 Ct. Cl. 247, 254, 462 F. 2d 1400, 1404 (1972); *United States* v. *Wegematic Corp.*, 360 F. 2d 674 (2d Cir. 1966); and *J. A. Maurer, Inc.* v. *United States*, 202 Ct. Cl. 813, 485 F. 2d 588 (1973). *Austin* is distinguished since the contractor did not furnish the specification as was done in *Austin. Bethlehem* is not applicable because the Government did not rely here on any superior expertise claimed by the contractor. Nor did contractor propose a revolutionary advance in the state of the art, as in *Wegematic.* Nor was there a contractor's mistake in technical judgment associated with inferior expertise of the Government as in *Maurer.*

The trial judge also correctly found that plaintiff had not waived all the deficiencies in the specifications, though it had waived some. In short, the trial judge found fault on both sides and yet upheld the default termination. The trial judge declined to find the fault entirely beyond the control of the contractor.

We have a somewhat novel problem. In our precedent cases deficient specifications have been entirely the risk of one party or the other. Here we have multiple and independent deficiencies, so that even if one were properly cured, the others would still bar the door to success.

This leads to the first question: was plaintiff properly defaulted?

## V

A default termination is the Government's way of telling its contractor that he has breached the contract. In a default termination, the Government assumes the risk of having the default termination converted to a convenience determination if the Government is wrong and the contract so provides, as here.

The second item to note is that it takes only one valid defense to void a default termination. If the Government is not sure whether plaintiff has defaulted, it can seek further assurances as the Government did in this case several times. But when the Government actually issues the termination notice, it runs the risk of being wrong.

Impossibility is a classic defense to breach of contract.

By issuing defective specifications, some not waived, the Government has put this case somewhat in the category of our recent *Foster Wheeler Corp.*, *supra*, decision and related cases. There the court, 206 at 557, 513 F. 2d at 601, noted certain features common to such cases:

1. a fixed-price, supply contract,
2. detailed performance specifications drawn up by the Government,
3. a requirement that the contractor submit a Technical Proposal,
4. meetings of the parties when the contractor's difficulties became apparent, and
5. an eventual relaxation of specifications by the Government so that the contractor would be able to complete the contract.

Reviewing this list of factors, numbers 1 and 4 apply and already have been amply described. Number 2 also applies. Although the specifications were mixed performance and design specifications, the design specifications (which by drawing fixed weight, shape, and dimensions of the antenna) here left the contractor no elbow room to avoid the impossibility of the specifications. Had the Air Force given plaintiff the waivers it sought, to avoid the design specifications, this would be a different case. But by insisting on its design specifications, despite notice of their deficiencies, the Air Force accepted the risk that its design specifications were non-performable. Number 3 is not applicable here. Any prejudice to the Air Force from the lack of a technical proposal is eliminated by the Air Force's prior experience with Tamar Antennas which provided the Air Force ample notice of the inadequacies of its specifications—inadequacies that for some reason were not corrected in a timely fashion by the Air Force.

Number 5 of the list points up the unique item about this case. Normally the Government gives in when the error of its specifications is amply demonstrated. Here the Government did not give in. Instead the Government waived any further right to performance by terminating plaintiff for default, running the risk (as in all default terminations) that the termination was not proper.

It seems apparent in light of what has been said that on the termination date plaintiff was entitled either to a convenience termination or to new specifications with the impossibilities eliminated and an extended completion date provided.

Once the Government terminated plaintiff, it found no other manufacturer who would or could perform its impossible specifications upon reprocurement. Instead, the offending design specifications had to be waived and the Adams-Russell antenna procured. Not only was the Adams-Russell antenna twice as heavy (negating the weight saving that had prompted adoption of the Tamar Antenna in the first place) but it also cost significantly more (the Air Force excess—reprocurement-cost notice claimed it cost $410,994, to obtain from Adams-Russell the 749 antennas Dynalectron had agreed to supply for $288,470.44 (including tests and test data)). Since the reprocurement contract was not signed until January 1967, it is also questionable if the Air Force saved any time. (Plaintiff's single-blade antenna may have been available sooner—and cheaper.)

## VI

However, because of plaintiff's partial waiver and its deficient contract administration, we do not think plaintiff is entitled to shift all of its losses to the Government. In view of the share plaintiff's fault played in bringing the situation about, and its repeated failure to point out the Government's errors, which if done, might have enabled the Government to minimize its own losses as well as plaintiff's, we do not think it would be equitable to shift all the costs to the defendant, as in the normal convenience termination.

As the trial judge noted, characterizing the termination is merely the first step in ascertaining liability for damages.

Each tribunal agreed that the specifications were deficient. However, the trial judge disagreed with the Board on the waiver issue, as do we. The trial judge and we conclude that plaintiff had at least two separate and independent impossibility claims—both blocking the road to success. Some were waived. The others not.

The waiver doctrine, as noted in *Foster Wheeler*, *supra*, 206 Ct. Cl. at 558, 513 F. 2d at 602, (citing *Ling-Temco-Vought, Inc.* v. *United States*, 201 Ct. Cl. 135, 475 F. 2d 630 (1973)), rests on the premise that delay in asserting rights prejudices the Government by running up recoverable costs. Here it is practically impossible to determine the prejudice to the Government. In the past, when notified of the antenna-length specification problem, the Air Force simply granted a waiver to the WCLG-3B specification. Here, even when plaintiff gave the Government notice of the problem on January 3, 1966 (and repeated it again in later summaries of the January 1966 test data), no significant response was forthcoming from the Government over the problem.

We note that the Board and the trial judge thought they were splitting the costs by denying defendant any reprocurement costs. However, the Board also denied defendant reprocurement costs on the obviously valid ground that there was no reprocurement—in effect letting defendant walk away from a mess largely of its own creation with no liability. If there was no reprocurement the Board decision does not divide the costs.

The trial judge says plaintiff must be held to the "literal terms" of the provisions of the contract it executed, referring in this connection to Art. 11(e) by which a default termination is converted into a convenience termination only if "the failure to perform the contract is due to causes beyond the control and without the fault or negligence of the contractor * * *." Since the contractor was not without fault or negligence, it cannot have a settlement by the convenience termination formula. So much is clear. But in holding that by Art. 11(e) the contractor wholly forfeits an otherwise valid claim, the trial judge goes beyond the literal language and beyond any implication that could reasonably be imputed to its authors.

In the absence of such a clause a wrongful termination for default is a breach. *Dale Construction Co.* v. *United States*, 168 Ct. Cl. 692, 721 (1964). As there held, some fault on the contractor's side does not bar him from breach recovery, with appropriate cost sharing where fault is mutual (at 706). The Government here could have limited its prior breach liability by a proper convenience termination. *Nolan Bros., Inc.* v. *United States*, 186 Ct. Cl. 602, 405 F. 2d 1250 (1969). But it would have had to reimburse the costs of the contractor by the convenience termination formula. The clause surely could not have been intended to enable the Government to avoid all liability for antecedent breaches by trumping up a wrongful default termination, yet that is the power the trial judge gives it.

The contract we think does not provide a measure of damages and it has to be provided by common law or equitable principles. When, as here, the defaulted contractor is not without fault or negligence, but the default was wrongful because of the Government's previous fault or negligence, Art. 11(e) may impose a ceiling in that the damages perhaps may not exceed those that would be computed by the termination formula.

If Art. 11(e) does not reduce the damages awardable to zero, we must go elsewhere to learn how to measure them. We find instruction in *National Presto Industries, Inc.* v. *United States*, 167 Ct. Cl. 749, 338 F. 2d 99 (1964), *cert. denied*, 380 U.S. 962 (1965). There in a mutual fault situation we effected a reformation of the contract on the theory of a mutual mistake, sharing the losses equally. Since, unlike here, we there rejected the claim for breach liability and had therefore to find a remedy under the contract, this case would seem *a fortiori* eligible for a similar innovative approach. The equitable powers of this court in actions at law are not limited to instances of mutual mistake. They extend also to unilateral mistakes when they are knowingly and unfairly exploited by the other side. *Chernick* v. *United States*, 178 Ct. Cl. 498, 372 F. 2d 492 (1967). The plaintiff here thought it was contracting to deliver the previously accepted Tamar/Stoddart design of antenna. By the time it discovered its error, it was in a situation of performing an R&D contract under ostensible fixed-price production contract terms. This situation defendant exploited to put plaintiff more and more in the hole, and finally, by a wrongful default termination, defendant sought to throw the entire costs of the numerous errors of both sides on the plaintiff. In *National Presto*, in effect we converted the experiments there performed into a joint venture at shared cost. Here, since the convenience termination formula is ruled out, except as a ceiling, we think the formula of shared costs as in a joint venture is likewise applicable. The Government benefited from plaintiff's flounderings at least to this extent: it tried out a number of false leads and learned what would not work at plaintiff's cost.

The decision we arrive at is far more equitable than the Board's. The Government retains its liability for issuing defective specifications. *Foster Wheeler*, *supra; Hol-Gar Mfg. Corp.* v. *United States*, 175 Ct. Cl. 518, 360 F. 2d 634 (1966 ); *Natus Corp.* v. *United States*, 178 Ct. Cl. 1, 371 F. 2d 450 (1967); *Tecon Corp.* v. *United States*, 188 Ct. Cl. 436, 411 F. 2d 1271 (1969); *Tombigbee Constructors* v. *United States*, 190 Ct. Cl. 615, 420 F. 2d 1037 (1970). But the Government also carries only a share of the damage assessment because of plaintiff's contributory errors. The result in this case rewards no one for careless contracting, whereas the mere denial of reprocurement costs exonerates the Government of all fault—in a situation where Government errors were the greater cause of the failure of performance (even though aggravated severely by plantiff's failure to give timely notice of the early-detected defects). Consequently we have differed with the Board and the trial judge and applied the precedents of this court to work "jury verdict" equity among the parties and encourage correct contract procedures on both sides.

Accordingly the recommended decision of the trial judge is rejected and the parties are to share equally the allowable and reasonable costs normally recoverable by plaintiff in a convenience termination. Since this is a breach case, the cause is remanded to the trial division for quantum proceedings under Rule 131(c). Both motions for summary judgment are allowed in part and denied in part, pursuant to this opinion, and judgment is entered for plaintiff to the extent called for in this opinion.

518 F. 2d 1309

## THE UNITED STATES v. MESCALERO APACHE TRIBE, ET AL.

Appeal No. 2–74
Ind. Cl. Comm. Docket No. 22–G

## THE UNITED STATES v. THE SHOSHONE-BANNOCK TRIBES OF THE FORT HALL RESERVATION, IDAHO

Appeal No. 10–74
Ind. Cl. Comm. Docket No. 326–C

## THE UNITED STATES v. TE-MOAK BANDS OF WESTERN SHOSHONE INDIANS OF NEVADA, ET AL.

Appeal No. 12–74
Ind. Cl. Comm. Docket No. 326–A
31 Ind. Cl. Comm. 427 (1973)
33 Ind. Cl. Comm. 417 (1974)
[Decided July 11, 1975]*

ON APPEALS FROM THE INDIAN CLAIMS COMMISSION

**Indian claim; appeal from Indian Claims Commission; interest on Indian funds deposited in United States Treasury.**—Before the

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*The motions for rehearing filed by Mescalero Apache Tribe and by Shoshone-Bannock Tribes and Te-Moak Bands of Western Shoshone Indians were denied October 3, 1975. J. Davis dissented with following comments: "My usual practice, when I have been in dissent, is not to vote for rehearing (even though I continue to believe the decision of the majority to be wrong) unless there are extraordinary circumstances calling for reconsideration—rather than the error (in my view) of the initial decision. Here I find such circumstances in the failure of the court's opinion to deal explicitly and adequately with the appellants' claim under the 'fair and honorable dealings' clause (apart from the 1841 statute). I therefore vote to rehear the case on that issue alone."

On January 2, 1976 Mescalero Apache Tribe, et al. filed a petition for certiorari.

Indian Claims Commission the Indian plaintiffs claimed simple and compound interest on the trust funds ("Indian Moneys, Proceeds of Labor") (I.M.P.L.) for the period since passage of the Act of March 3, 1883 authorizing deposit of said funds in the United States Treasury for the benefit of the Indians to passage in 1930 of an Act wherein Congress specifically directed that interest be paid thenceforth at the rate of 4% per annum. The Commission awarded simple and compound interest for said period and the Government has appealed, contesting the legality of such award. The Te-Moak Bands of Western Shoshone Indians of Nevada has cross-appealed from an order of the Commission denying interest on shortages in the payments due from the Government under the Treaty of October 1, 1863. The Act of March 3, 1883 did not provide for payment of interest on the I.M.P.L. funds, the amendments of 1887 and 1926 to the Act omitted provision for such payment, and the Executive Branch understood that it possessed no authority to pay interest. It is *held* (1) that the award of simple and compound interest by the Commission was contrary to law, unless there was a contract, treaty or agreement between the Indians and the United States or an Act of Congress expressly providing for such payment; (2) that the 1841 Act on which the Commission relied for authority to award simple and compound interest on said funds did not create any obligation on the Government to pay interest on trust funds, but only provided that they should be invested in bonds of the United States rather than state bonds if any statute or treaty required the funds to be productive; (3) that the Indian Claims Commission Act, also relied on by the Commission, does not authorize the latter to award simple or compound interest on a claim against the Government in any non-eminent domain cases absent a contract, treaty or statute expressly providing therefor, and here there is no such contract, treaty or statute; and (4) that as regards the Te-Moaks cross-appeal, the Commission correctly treated the shortages in payments as breaches of contractual obligations and in thus denying interest. The decision and order of the Commission awarding simple and compound interest, whether called interest or damages, to the Indian Tribes on said funds from 1883 to 1930 is *reversed*. The decision and order of the Commission respecting the Te-Moaks claim is *affirmed*. The case is remanded to the Commission for further proceedings in accordance with this opinion.

## Claims against the United States; sovereign immunity.

**[1]** It is fundamental that the Government has sovereign immunity from suit except where Congress has by legislation expressly waived such immunity. This principle applies to claims for interest against the United States. The waiver of sovereign immunity cannot be implied but must be unequivocally expressed.

U S ⚿ 125(5)

**Interest; claims against the United States; generally.**

[2] Pursuant to 28 U.S.. § 2516(a), interest on a claim against the United States is allowed in a judgment of this court only when authorized by contract or statute expressly providing therefor. The character or nature of "interest" cannot be changed by calling it "damages," "loss," "earned increment," "just compensation," "discount," "offset," or "penalty" or any other term because it is still interest and the no-interest rule applies.

U S 🔑 110

**Interest; claims against the United States; generally.**

[3] That an award of interest on a claim against the United States would be just or equitable, and no matter how high the purpose or how benevolent the motive, does not empower the Indian Claims Commission or this court to make it, unless the requirements of the no-interest rule are met.

U S 🔑 110

**Statutes; construction and operation; investment of Indian trust funds; Act of September 11, 1841.**

[4] The sole purpose of the Act of September 11, 1841, 5 Stat. 465, was to prohibit future investment in state bonds of trust funds on deposit in the U.S. Treasury that were required to be invested, and to accomplish this purpose the Act required such funds to be invested *only* in bonds of the United States, there being no provision for payment of interest. The Congress could not have intended the Act to apply to "Indian Moneys, Proceeds of Labor" because very few of these funds were in existence, none were on deposit in the Treasury at that time, and, being of a transient character, they did not lend themselves to investment purposes. The 1841 Act as regards Indian trust funds was limited to certain treaties with the Indians, containing stipulations for payment to them annually of interest upon the proceeds of lands ceded by them, and it was clearly to trusts of this definite character, established by law, that the Act applied.

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**Statutes; construction and operation; administrative interpretation.**

[5] Where, during the period 1841 to 1930, no one in the Executive Department charged with handling and investing Indian trust funds construed the Act of September 11, 1841 as authority to invest such funds except those regulated by treaty nor as a law requiring the Government to pay interest thereon, this long administrative practice, concurred in by the Congress, is entitled to great weight in determining the intent of Congress when it enacted the 1841 statute.

Statutes 🔑 219(6)

**Interest; claims against United States; compound interest.**

[6] Where a treaty or statute requires payment of interest, only simple interest is intended, and compound interest cannot be awarded against the Government.

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**Indian claims; interest on claim against United States; Indian Claims Commission Act.**

[7] The Indian Claims Commission Act does not authorize the Commission to award simple or compound interest on a claim against the Government in any non-eminent domain case unless a contract, treaty or statute expressly so provides.

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**Indian claims; interest on awards; contract v. trust obligation.**

[8] Shortages in payments by the United States required by treaty are regarded as breaches of contractual obligations rather than as breaches of trust, and accordingly interest is not payable on an award for breach of contract.

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*A. Donald Mileur*, with whom was *Assistant Attorney General Wallace H. Johnson*, for appellant. *Richard L. Beal*, attorney for appellant in No. 2–74. *Craig A. Decker*, attorney for appellant in Nos. 10–74 and 12–74.

*I. S. Weissbrodt*, attorney of record for Appellee, Mescalero Apache Tribe. *Weissbrodt & Weissbrodt*, *Richmond F. Allan* and *Howard L. Sribnick*, of counsel.

*Pierre J. LaForce* for Appellees The Shoshone-Bannock Tribes and Te-Moak Bands of Western Shoshone Indians. *Frances L. Horn*, attorney of record. *Wilkinson, Cragun & Barker* and *Robin A. Friedman*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, DAVIS, SKELTON, NICHOLS, KUNZIG, and BENNETT, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

This is an appeal by the Government from orders of the Indian Claims Commission (Commission) in three Indian accounting cases (consolidated for this appeal) in which the Commission awarded simple and compound interest from 1883 to 1930 against the Government on trust funds it held for the three appellee Indian Tribes, notwithstanding the provisions of 28 U.S.C. § 2516(a) (1970) and the well established rule set forth in many decisions of the Supreme Court and of this court and other courts that in noneminent domain cases interest on a claim against the United States can be allowed *only* under a contract, treaty, or an Act of Congress *expressly* providing for the payment of interest. The orders of the Commission awarding interest cannot stand, and we reverse.

One of the Indian Tribes, the Te-Moak Bands of Western Shoshone Indians of Nevada (Te-Moaks), filed a cross-appeal from an order of the Commission denying it interest on shortages in the payments due it by the Government under the Western Shoshone Treaty of October 1, 1863, 18 Stat. 689. The Commission held that these shortages were never paid and were never set up as trust funds and could not bear interest as they never in fact existed. We think the order of the Commission in this regard was correct and we affirm. A discussion of the law and the facts follows.

The Government appealed from the following orders of the Commission:

(1) The order of October 4, 1973, 31 Ind. Cl. Comm. 427, 557, and 559, Te-Moak Bands of Western Shoshone Indians of Nevada, Docket No. 326–A (Appeal No. 12–74) and Mescalero Apache Tribe (Mescalero Apaches), Docket No. 22–G (Appeal No. 2–74) holding that the United States is liable for simple interest and compound interest on the fund known as "Indian Moneys, Proceeds of Labor" (I.M.P.L. Funds),[1] from 1883 to 1930.

(2) The order of January 16, 1974 (unreported), holding that the above order of October 4, 1973, was the law of the case in Shoshone-Bannock Tribes of the Fort Hall Reservation (Shoshone-Bannocks), Docket No. 326–C (Appeal No. 10–74).

The Te-Moaks cross-appealed as to that part of the above order of October 4, 1973, that denied them interest on the unpaid shortages of treaty funds mentioned above. They also cross-appealed from the Commission's order of April 4, 1974, 33 Ind. Cl. Comm. 417, 435 denying their motion for rehearing on the decision of October 4, 1973, above.

By way of background, it should be pointed out that prior to 1883 the I.M.P.L. Funds were not extensive and were held by local Government agents. These agents disbursed these funds from time to time to meet the needs of the Indians. Such expenditures were usually made after consultation with the Indians and with their approval. However, by 1883 the I.M.P.L. Funds had begun to increase in amount and it was decided that they should be taken from the local agents and deposited in the U.S. Treasury for the benefit of the Indians. The Act of March 3, 1883, ch. 141, 22 Stat. 590 was the result. It reads in pertinent part as follows:

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[1] This fund was composed of miscellaneous receipts from Indian reservations derived from such sources as sales of grazing leases, oil and gas leases, timber, coal and other natural resources. They were deposited in the Treasury pursuant to the Act of March 3, 1883, 22 Stat. 590, as amended, 25 U.S.C. § 155 (1970).

> The proceeds of all pasturage and sales of timber, coal, or other product of any Indian reservation, except those of the five civilized tribes, and not the result of the labor of any member of such tribe, shall be covered into the Treasury for the benefit of such tribe under such regulations as the Secretary of the Interior shall prescribe; and the Secretary shall report his action in detail to Congress at its next session.

Significantly, the Act makes no mention of a duty to invest such proceeds or to pay interest thereon. To the contrary, it expressly provides that the proceeds "shall be covered [deposited] into the Treasury for the benefit of such tribe under such regulations as the Secretary of Interior shall prescribe."

Pursuant to the 1883 Act, the I.M.P.L. Funds were deposited in the Treasury for the first time in one common fund for all of the Indians. But due to a technicality in the Act, the Secretary of the Treasury would not allow the Secretary of the Interior to withdraw any of these funds without an appropriation by Congress. This proved to be a cumbersome arrangement because the money was needed from time to time to meet the needs of the Indians. As a consequence, the Act was amended by the Act of March 2, 1887, ch. 320, 24 Stat. 463 which provided in pertinent part as follows:

> That the Secretary of the Interior is hereby authorized to use the money which has been or may hereafter be covered into the Treasury under the provisions of the act approved March third, eighteen hundred and eighty-three, and which is carried on the books of that Department under the caption of "Indian moneys, proceeds of labor," for the benefit of the several tribes on whose account said money was covered in, in such way and for such purposes as in his discretion he may think

> best, and shall make annually a detailed report thereof to Congress.

This 1887 amendment gave the Secretary of the Interior the authority to use the I.M.P.L. Funds in his discretion for the benefit of the Indians without an appropriation by Congress. It is significant that the 1887 amendment, like the Act of 1883, did not provide for the payment of interest on I.M.P.L. Funds. Actually, these funds were transient in character because they were paid out from time to time to provide for the needs of the Indians. Obviously, funds of this character did not lend themselves to investment purposes to earn interest because they were not available for a sufficient length of time to allow them to be used to purchase stocks or bonds or other securities that would earn interest only after a long period of time. It is clear that Congress did not intend to pay interest on these funds nor to require them to be invested in interest bearing stocks, bonds, or other securities. The existing facts mentioned above militate against any such intention, and clearly the Acts of 1883 and 1887 did not require the Government to pay interest on these funds nor that they be made productive otherwise.

The statute controlling I.M.P.L. Funds was amended again by the Act of May 17, 1926, ch. 309, 44 Stat. 560 and provided in pertinent part as follows:

> * * * That hereafter all miscellaneous revenues derived from Indian reservations, agencies, and schools, which are not required by existing law to be otherwise disposed of, shall be covered into the Treasury of the United States under the caption "Indian moneys, proceeds of labor," and are hereby made available for expenditure, in the discretion of the Secretary of the Interior, for the benefit of the Indian tribes, agencies, and schools on whose behalf they are collected, subject, however, to the limitations as to tribal funds, imposed by section 27 of the act of May 18, 1916 (Thirty-ninth Statutes at Large, page 159).

This amendment, like the Acts of 1883 and 1887 did not provide for the payment of interest on I.M.P.L. Funds. By this time it was clear that Congress knew that no interest was being paid on these funds and that they were not otherwise productive, and that Congress approved of this manner of handling I.M.P.L. Funds. This knowledge of Congress and its approval of the administrative interpretation of the I.M.P.L. statutes as not to require payment of interest by the Government on I.M.P.L. Funds or make them otherwise productive is forcefully shown in the records of this case by the reports to Congress by the Commissioner of Indian Affairs for 1904 and 1905 which stated that Indian funds were divided into two categories, namely, (1) "Trust Funds and Trust Lands" and (2) "Income of Indian Tribes." Under the trust funds classification were listed all the funds *required to be productive* as a trust fund held by the Government by an act, resolution or treaty. Such funds bore interest and the principal amounts and the interest earned were shown together with the appropriate congressional authority for each tribe for each year. The second classification "Incomes of Indian Tribes" consisted of four sub-classifications, namely, (1) "Interest on trust fund," (2) "Treaty and agreement obligations," (3) "Gratuities," and (4) "Indian moneys, proceeds of labor and miscellaneous (I.M.P.L. Funds)." It was obviously clear to Congress that no interest was being paid on I.M.P.L. Funds and that Congress approved of this manner of handling these funds.

This brings us to 1929 when the Secretary of the Interior recommended to Congress that the noninterest bearing I.M.P.L. Funds held by the Government for Indians be made interest bearing funds. It is significant that he stated in his recommendation:

> It is conceded that there is no legal obligation to pay interest on these funds * * *.

The Congress responded by enacting the Act of February 12, 1929, ch. 178, 45 Stat. 1164, which provided in pertinent part:

> * * * That all money in excess of $500 held by the United States in a trust fund account, and carried on the books of the Treasury Department to the credit of an Indian tribe, if the payment of interest thereon is not otherwise authorized by law, shall bear simple interest at the rate of 4 per centum per annum from the date of the passage of this Act. * * *

Although it appears that the Secretary of Interior had intended that I.M.P.L. Funds would be included in the 1929 legislation, the Comptroller General ruled on May 31, 1929, that it did not because the I.M.P.L. Fund was not "carried on the books of the Treasury Department to the credit of an Indian Tribe." Decision A-27308, 8 Comp. Gen. 625.

Because of this technicality, the Secretary of the Interior requested additional legislation that would make I.M.P.L. Funds interest bearing. The Congress responded by enacting the Act of June 13, 1930, ch. 483, § 2, 46 Stat. 584, that provided in pertinent part as follows:

> Sec. 2. All tribal funds arising under the Act of March 3, 1883 (22 Stat. 590), as amended by the Act of May 17, 1926 (44 Stat. 560), now included in the fund 'Indian Money, Proceeds of Labor,' shall, on and after July 1, 1930, be carried on the books of the Treasury Department in separate accounts for the respective tribes, and all such funds with account balances exceeding $500 shall bear simple interest at the rate of 4 per centum per annum from July 1, 1930.

The record from 1883 to 1929–30 is unequivocal. The Executive Branch understood that it possessed no authority to pay interest on I.M.P.L. Funds. Congress not only concurred in this construction, but, in each of its Acts directly involving I.M.P.L. legislation (Acts of 1883, 1887, and 1926), conspicuously omitted any provision for the payment of interest. Under the well established rule against interest, each of these omissions was an unequivocal declaration by Congress that no interest thereon was intended.

With this background, the record shows in these accounting cases that in the *Te-Moak* case, Docket No. 326–A, the Government filed its accounting report showing that $314,241.19 was deposited in its I.M.P.L. account between 1899 and 1951, and that no interest was paid on the fund until June 30, 1930, after which date interest was paid pursuant to the Act of June 13, 1930, at the rate of four percent per annum.

In Shoshone-Bannock, Docket No. 326–C the accounting report of the Government showed that $380,628.76 was deposited in its I.M.P.L. account between 1887 and 1951, and that no interest was paid on the account prior to June 30, 1930, after which date interest was paid pursuant to the Act of June 13, 1930, at the rate of four percent per annum.

In Mescalero Apache, Docket No. 22-G, the accounting report of the Government showed that $1,670,620.38 was deposited in the I.M.P.L. account between 1887 and 1950, and that no interest was paid on this account until June 30, 1930, after which interest was paid pursuant to the Act of June 13, 1930, at the rate of four percent per annum.

In these accounting cases, which were filed under the Indian Claims Commission Act of August 13, 1946 (25 U.S.C. § 70a (1970), 60 Stat. 1050), the Indians claimed simple and compound interest on the above I.M.P.L. Funds from 1883 when they were first deposited in the Treasury to 1930 when the Congress directed for the first time in the Act of 1930 that interest be paid thenceforth at the rate of four percent per annum. The Commission allowed the claim and awarded the Indians simple and compound interest against the United States for the period stated. The legality of this award is before us for determination.

It is obvious that the award is in direct conflict with 28 U.S.C. § 2516(a) (1970), which provides as follows:

> § 2516. Interest on claims and judgments.
> (a) Interest on a claim against the United States shall be allowed in a judgment of the Court of Claims *only* under a contract or Act of Congress *expressly providing for payment thereof.* [Emphasis supplied.]

The awards of interest is also in conflict with many decisions of the Supreme Court and of this court that interest may not be allowed on a claim against the United States in noncondemnation cases unless there is a contract or a statute expressly providing for the payment of interest. These cases will be discussed below.

It is fundamental that the Government has sovereign immunity from suit except where Congress has by legislation expressly waived such immunity. This principle applies to claims for interest against the United States. *See Ute Indians* v. *United States*, 45 Ct. Cl. 440, 470 (1910); *United States* v. *North Carolina*, 136 U.S. 211 (1890); *United States* v. *Sherman*, 98 U.S. 565 (1878); *United States ex rel. Angarica* v. *Bayard*, 127 U.S. 251, 260 (1888); *United States* v. *N.Y. Rayon Importing Co.*, 329 U.S. 654, 658–59 (1947); and *Smyth* v. *United States*, 302 U.S. 329 (1937).

The rule of sovereign immunity from suit against the Government without its consent is firmly established in our judicial system. The following cases are of interest in this regard:

In *Nassau Smelting & Refining Works* v. *United States*, 266 U.S. 101 (1924), the Supreme Court held:

> * * * The objection to a suit against the United States is fundamental, whether it be in the form of an original action or a set-off or a counterclaim. Jurisdiction in either case does not exist unless there is *specific congressional authority* for it. * * * [*Id.* at 106.] [Emphasis supplied.]

Again, in *United States* v. *Sherwood*, 312 U.S. 584 (1941), the Supreme Court said:

> The United States, as sovereign, is immune from suit save as it consents to be sued, *United States* v. *Thompson*, 98 U.S. 486; *United States* v. *Lee*, 106 U.S. 196; *Kansas* v. *United States*, 204 U.S. 331; *Minnesota* v. *United States*, 305 U.S. 382, 387; *Keifer & Keifer* v. *Reconstruction Finance Corp.*, 306 U.S. 381, 388; *United States* v. *Shaw*, 309 U.S. 495 (see cases cited in *The Pesaro*, 277 F. 473, 474, *et seq.*), and the terms of its consent to be sued in any court define that court's jurisdiction to entertain the suit. *Minnesota* v. *United States*, *supra*, 388 and cases cited; cf. *Stanley* v. *Schwalby*, 162 U.S. 255, 270. * * * [*Id.* at 586–87.]

Many cases have held that the waiver of sovereign immunity cannot be implied but must be unequivocally expressed. In *General Mut. Ins. Co.* v. *United States*, 119 F. Supp. 352 (N.D.N.Y. 1953), the court said:

> It is beyond argument that the United States may be sued only where its immunity has been specifically waived by statute, and that *such waiver may not be implied in the construction of an ambiguous statute.* [Emphasis supplied.] [*Id.* at 354.]

In *Leyerly v. United States*, 162 F. 2d 79 (10th Cir. 1947), the court held:

> *The government does not consent to be sued by implication*, and consent to be sued should not be extended beyond the plain terms of the authorizing statute. *Price* v. *United States and Osage Indians*, 174 U.S. 373, 19 S. Ct. 765, 43 L. Ed. 1011; *Eastern Transportation Co.* v.

> *United States*, 272 U.S. 675, 47 S. Ct. 289, 71 L. Ed. 472; * * *. [Emphasis supplied.] [*Id.* at 84.]

In the case of *North Dakota-Montana Wheat Growers' Ass'n* v. *United States*, 66 F. 2d 573 (8th Cir. 1933), *cert. denied*, 291 U.S. 672 (1934) the court said:

> It is fundamental that the United States cannot be sued without its permission, and that permission must be specifically granted by Congress. *It will not be implied.* It is a deep-rooted principle in the fabric of all English speaking countries that a sovereign is immune from suits in its own courts. In *Nassau Smelting & Refining Works, Ltd.* v. *United States*, 266 U.S. 101, 106, 45 S. Ct. 25, 69 L. Ed. 190, the court said: "The objection to a suit against the United States is fundamental, whether it be in the form of an original action, or a set-off, or a counterclaim. Jurisdiction in either case does not exist, unless there is specific congressional authority for it. * * *" [Emphasis supplied.] [*Id.* at 577.]

In *United States* v. *King*, 395 U.S. 1 (1969), the Supreme Court said:

> * * * [J]urisdiction to grant relief depends wholly upon the extent to which the United States has waived its sovereign immunity to suit and that *such a waiver cannot be implied but must be unequivocally expressed. United States* v. *Sherwood*, 312 U.S. 584. [Emphasis supplied.] [*Id.* at 4.]

These decisions are especially applicable to the case before us, because here there was no contract nor statute expressly providing for the payment of interest on the I.M.P.L. Funds of the Indians. Furthermore, there was no Act of Congress that specifically and unequivocally waived the sovereign immunity of the Government to suit for interest on I.M.P.L. Funds by the Indians. It follows, therefore, that the Commission was without jurisdiction or authority to award the Indians interest against the United States in this case.

The allowance of interest by the Commission is directly contrary to the many court decisions that hold that interest cannot be awarded against the Government in the absence of a contract or a statute expressly providing for interest. We will now consider some of those cases.

In the early case of *United States ex rel. Angarica* v. *Bayard*, *supra*, the Supreme Court announced the correct rule as to the allowance of interest against the United States, which is the law at the present time as follows:

> The case, therefore, falls within the well-settled principle, that the United States are not liable to pay interest on claims against them, in the absence of express statutory provision to that effect. It has been established, as a general rule, in the practice of the government, that interest is not allowed on claims against it, whether such claims originate in contract or in tort, and whether they arise in the ordinary business of administration or under private acts of relief, passed by Congress on special application. The only recognized exceptions are, where the government stipulates to pay interest and where interest is given expressly by an act of Congress, either by the name of interest or by that of damages.
>
> This appears from a succession of the opinions of the Attorneys General of the United States, given by Attorneys General Wirt, Crittenden, Legare, Nelson, Johnson, Cushing and Black, and appearing in the following volumes and pages of those opinions, as published: 1, 268; 1, 550; 1, 554; 3, 635; 4, 14; 4, 136; 4, 286; 5, 105; 7, 523; 9, 57; and 9, 449.
>
> Not only is this the general principle and settled rule of the executive department of the government, but it has been the rule of the legislative department, because Congress, though well knowing the rule observed at the Treasury, and frequently invited to change it, has refused to pass any general law for the allowance and payment of interest on claims against the government. Such statutes for the payment of interest as have been passed, apply to specific cases enumerated in the several statutes, and do not cover the present case.
>
> The principle above stated is recognized by this court. In *Tillson* v. *United States*, 100 U.S. 43, 47, this court, speaking of the rule that interest is recoverable between citizens if a payment of money is unreasonably delayed, says that with the government the rule is different, and that the practice has long prevailed in the departments of not allowing interest on claims presented, except it is in some way specially provided for. See also *Gordon* v. *United States*, 7 Wall. 188, and *Harvey* v. *United States*, 113 U.S. 243, 248, 249. [127 U.S. 260.]

The rule against allowing interest was stated again by the Supreme Court in *United States.* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585 (1947) as follows:

> The pertinent part of § 177(a) of the Judicial Code

provides that "No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, * * *" Section 177(a) thus embodies the traditional rule that interest cannot be recovered against the United States upon unpaid accounts or claims in the absence of an express provision to the contrary in a relevant statute or contract. *Tillson v. United States*, 100 U.S. 43, 47; *United States* v. *North American Co.*, 253 U.S. 330, 336; *United States* v. *Goltra*, 312 U.S. 203, 207. * * *

* * * The sole issue thus becomes whether there is any express provision in the Act or in the lease permitting the recovery of interest under the circumstances. Only if there is such a provision can respondent avoid the traditional rule set forth in § 177(a).

* * * * *

But in order to override the historical rule codified in § 177(a), something more is necessary than an equivocal use of the term "just compensation." It is not enough that the term might be construed to include the payment of interest. As § 177(a) itself indicates, there must be a provision in the contract "expressly stipulating for the payment of interest." That provision must be affirmative, clear-cut, unambiguous; and an unexpressed intention by the parties that the term "just compensation" be construed to include interest is insufficient. *Likewise, where a statute is relied upon to overcome the force of § 177(a), the intention of Congress to permit the recovery of interest must be expressly and specifically set forth in the statute. Tillson* v. *United States, supra,* 46; *United States ex rel. Angarica* v. *Bayard*, 127 U.S. 251, 260. Mere use of the term "just compensation," without more, is no substitute for an express provision for interest.

Here neither the Act of March 30, 1920, nor the lease under which respondent operated contains an express provision for the payment of interest, either in addition to or as a part of the "just compensation" to be paid to respondent. If the United States had desired to provide by statute or to contract in the lease for the payment of interest, it would have been easy to have said so in express terms. Because it did not say so, we are led irresistibly to the conclusion that it did not intend to negative the effect of § 177(a) in this instance. *Tillson* v. *United States, supra.* [Footnote omitted.] [Emphasis supplied.] [*Id.* at 588–590.]

Again in *United States* v. *N.Y. Rayon Importing Co.*, 329 U.S. 654 (1947), the Supreme Court held:

> In our opinion, § 177(a) of the Judicial Code prohibits the award of any interest under the circumstances of this case. Section 177(a) provides that "No interest shall be allowed on any claim up to the time of the rendition of judgment by the Court of Claims, unless upon a contract expressly stipulating for the payment of interest, * * *" As we recently pointed out in *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585, this provision codifies the traditional rule regarding the immunity of the United States from liability for interest on unpaid accounts or claims. In other words, in the absence of constitutional requirements, interest can be recovered against the United States only if express consent to such a recovery has been given by Congress. And Congress has indicated in § 177(a) that its consent can take only two forms: (1) *a specific provision for the payment of interest in a statute;* (2) an express stipulation for the payment of interest in a contract duly entered into by agents of the United States. Thus *there can be no consent by implication or by use of ambiguous language*. Nor can an intent on the part of the framers of a statute or contract to permit the recovery of interest suffice where the intent is not translated into affirmative statutory or contractual terms. *The consent necessary to waive the traditional immunity must be express, and it must be strictly construed. Tillson* v. *United States*, 100 U.S. 43; *United States* v. *Thayer-West Point Hotel Co., supra.*
>
> Tested by those standards, the award of interest in this case cannot be sustained. There is obviously no contractual stipulation involved. And the appropriation statutes which cover the refunds here in issue contain no provision whatever for the recovery of interest. Act of May 14, 1937, 50 Stat. 137, 142; Act of June 25, 1938, 52 Stat. 1114, 1149. The traditional immunity of the United States, as codified in § 177(a), accordingly applies.
>
> The Court of Claims, without making a reference to § 177(a), sought to justify its award of interest on what it thought "would be right or just." * * *
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> * * * * *
>
> But assuming that the equities of the situation all favors the owners of the refund claims, the Court of Claims did not thereby acquire power to carve out an implied exception to the plain words of § 177(a). Had

> Congress desired to permit the recovery of interest in situations where the Court of Claims felt it just or equitable, it could have so provided. The absence of such a provision is conclusive evidence that the court lacks any power of that nature. Indeed, any other conclusion would permit the Court of Claims to supply the consent which only Congress can give to the imposition of interest against the United States.
>
> * * * Only Congress can take the necessary steps to waive the immunity of the United States from liability for interest on unpaid claims. Cf. *Smyth* v. *United States*, 302 U.S. 329, 353.
>
> * * * It is enough to note that the traditional rule embodied in § 177(a) is a complete one covering all types of claims, including those arising out of pre-existing judgments. As we have seen, any exception to that rule must be grounded upon *an express provision in a statute or contract*. It follows that any exception relating to pre-existing judgments must be traced to *specific language in a contract or some other statute*. Section 177(a) by itself warrants no such exception. * * *
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> * * * * *
>
> * * * Courts lack the power to award interest against the United States on the basis of what they think is or is not sound policy. We reiterate that *only express language in a statute or contract can justify the imposition of such interest.* Such language is absent in this instance.
>
> We accordingly reverse the judgment of the Court of Claims in No. 94 to the extent that it includes an award of interest. * * * [Emphasis supplied.] [*Id.* bridging pages 658–63.]

In the case of *Albrecht* v. *United States*, 329 U.S. 599 (1947), the Supreme Court said:

> Turning now to the right to interest under the contracts, and apart from the contention regarding the Fifth Amendment, we find that the contracts have no provision for payment of interest. No statute authorizes the payment of interest in cases like this. *In the absence of specific contract or statutory provisions no interest runs against the Government* even though the Government's payment for the contract purchases be delayed. See *Smyth* v. *United States*, 302 U.S. 329, 353; *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585, 588; *United States* v. *N.Y. Rayon Importing Co.*, 329 U.S. 654, 659–660. [Emphasis supplied.] [*Id.* at 605.]

The Supreme Court held in *United States* v. *Alcea Band of Tillamooks*, 341 U.S. 48 (1951):

> * * * We granted certiorari limited to the question presented by the award of interest. 340 U.S. 873 (1950).
>
> It is the "traditional rule" that *interest* on claims against the United States *cannot be recovered in the absence of an express provision to the contrary in the relevant statute or contract.* 28 U.S.C. (Supp. III) § 2516(a). *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585, 588 (1947), and cases cited therein. * * * [Emphasis supplied.] [*Id.* at 49.]

In the case of *Ramsey* v. *United States*, 121 Ct. Cl. 426, 101 F. Supp. 353 (1951), *cert. denied*, 343 U.S. 977 (1952), we held:

> However, the common law rule that delay or default in payment of money gives rise to a right to recover interest has been held not to be applicable to the sovereign government on grounds of public convenience, unless the sovereign's consent to pay interest has been exhibited by an act of the Congress, or by a lawful contract of its executive officers. *United States* v. *North American Transportation & Trading Co.*, 253 U.S. 330; *United States* v. *North Carolina*, 136 U.S. 211, 216; *United States ex rel. Angarica* v. *Bayard*, 127 U.S. 251; *Richmond, Fredericksburg & Potomac Railroad Co.* v. *United States*, 95 C. Cls. 244; *Hinds* v. *United States*, 70 C. Cls. 288, 293. Congress has specifically provided by an Act of June 25, 1948, ch. 646, sec. 1, 62 Stat. 978. U.S. Code Title 28 (Supp. IV), § 2516(a), that:
>
> > Interest on a claim against the United States shall be allowed in a judgment of the Court of Claims only under a contract or Act of Congress expressly providing for payment thereof.
>
> A provision in a Government contract for the payment of interest must be affirmative, clear-cut, and unambiguous. *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585. The Supreme Court has held that although an award of interest on a claim against the United States would be just or equitable, this fact alone does not empower the Court of Claims to make such an award on the basis of what they think is a sound policy. The immunity of the United States from liability for interest on unpaid claims is not to be waived by such policy arguments. *United States* v. *New York Rayon*

> *Importing Co.*, 329 U.S. 654. * * * [*Id.* at 431–32, 101 F. Supp at 356.]

We held in *Confederated Salish & Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451 (1966), *cert. denied*, 385 U.S. 921:

> For many decades *Congress has forbidden interest* on a plaintiff's claim in this court *unless a contract or a statute has "expressly" provided for interest.* 28 U.S.C. § 2516(a). *This rule has won strict adherence in many kinds of cases, including Indian claims. Tillson* v. *United States*, 100 U.S. 43 (1879); *United States* v. *North American Transp. Co.*, 253 U.S. 330, 336 (1920); *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585 (1947); *United States* v. *N.Y. Rayon Importing Co.*, 329 U.S. 654 (1947); *United States* v. *Alcea Band of Tillamooks*, 341 U.S. 48 (1951); *Loyal Band of Creek Indians* v. *United States*, 118 Ct. Cl. 373, 382–83, 97 F. Supp. 426, 431 (1951), *cert. denied*, 342 U.S. 813. * * * [Emphasis supplied.] [*Id.* at 454.]

The Indians and the Commission rely heavily on the decisions in *United States* v. *Blackfeather*, 155 U.S. 180 (1894) and *Peoria Tribe* v. *United States*, 390 U.S. 468 (1968) as authority for the allowance of interest here. Their reliance on those cases is misplaced, because they are clearly distinguishable and are not apposite. The Supreme Court held in those cases that treaties existed with the Indians that *required* the payment of interest. Of course, under those circumstances, it was proper for interest to be allowed and paid, as a treaty requirement for interest is one of the exceptions to the no-interest rule. But we have no such treaty here, and, accordingly, *Blackfeather* and *Peoria* are of no help to the Indians or the Commission.

The Commission attempts to avoid the no-interest rule by calling interest "damages." Here again the cases are squarely against this theory of the Commission. In *Moran Brothers Co.* v. *United States*, 61 Ct. Cl. 73 (1925), we held:

> * * * Calling interest "damages" or loss does not deprive it of being interest, and the statute forbids the allowance of interest. It is frequently the case that interest, where not stipulated for, is allowed by the courts as damages for the detention of money or as compensation to which a plaintiff is entitled, but this rule is

> not applicable to the sovereign, "and, as has been settled on grounds of public convenience, it is not to be awarded against a sovereign government, unless its consent to pay interest has been manifested by an act of its legislature or by a lawful contract of its executive officers." *United States* v. *North Carolina*, 136 U.S. 211, 216. See also *Sherman case*, 98 U.S. 565; *Angarica* v. *Bayard*, 127 U.S. 251, 260. [*Id.* at 106.]

In *Ramsey* v. *United States*, *supra*, we held:

> * * * The payment of interest as such was neither expressly provided for by the corporation's contract with the War Department, nor by any Act of Congress. Plaintiffs attempt to avoid the effect of this *by designating their claim as one for damages*, consisting of interest on amounts paid out by the corporation to third persons. But, as this court pointed out in *Moran Brothers Co.* v. *United States*, 61 C. Cls. 73, 106, "*Calling interest 'damages' or loss does not deprive it of being interest, and the statute forbids the allowance of interest.*" [Emphasis supplied.] [121 Ct. Cl. at 432, 101 F. Supp. at 356.]

The Supreme Court said in *Cherokee Nation* v. *United States*, 270 U.S. 476 (1926):

> * * * The additional interest now claimed is sought really *as damages* for the delay of Congress in appropriating the sum due in 1895 as the United States promised in the 1891 agreement. *But the rule as to interest against the United States does not allow us to adjudge interest as damages at all.* Congress must expressly provide for it or the contract must so provide. * * * [Emphasis supplied.] [*Id.* at 490.]

On occasion, courts have felt that certain special circumstances warranted an exception to the interest rule. In *Goltra* v. *United States*, 91 Ct. Cl. 42 (1940), because the jurisdictional act permitted judgments "for just compensation" the court concluded that:

> Judgment is entered for the plaintiffs in the sum of $350,000, with interest at six percent per annum, not as interest but as a part of just compensation, * * *. [*Id.* at 75.]

On appeal, the Supreme Court reversed, *United States* v. *Goltra*, 312 U.S. 203 (1941), holding that the traditional rule against allowing interest must be applied. [*Id.* at 207, 211.]

In *Thayer-West Point Hotel Co.* v. *United States*, 106 Ct. Cl. 60 (1946), this court concluded that:

> Both statute and contract expressly provide for the payment of "just compensation." * * * [*Id.* at 81.]

The court allowed four percent interest on the principal sum. On appeal, *United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585 (1947), the Supreme Court reversed our allowance of interest and after noting that the "just compensation" provisions "may or may not imply an obligation to pay interest" went on to state:

> But in order to override the historial rule [no interest against the United States] * * * something more is necessary than an equivocal use of the term "just compensation." It is not enough that the term might be construed to include the payment of interest. * * * [T]here must be a provision in the contract "expressly stipulating for the payment of interest." That provision must be affirmative, clear-cut, unambiguous; * * *. [*Id.* at 590.]

*See also United States ex rel. Angarica* v. *Bayard*, 127 U.S. 251, 259–60 (1888), wherein the United States had assumed a duty to invest certain trust moneys. Plaintiffs maintained that they were entitled to *incremental or income damages* on the principal amount. However, the Supreme Court pointed out "*but the claim in that respect is not different in character from what it would have been if * * * it were a claim for interest* * * *" [Emphasis supplied] and went on to hold that incremental *damages* based on the investment duty were barred by the general no-interest rule. *Angarica* is cited with approval in *United States* v. *Thayer-West Point*, *supra* at 590, and also in *Ramsey* v. *United States*, *supra* at 432.

Recent Indian cases, applying the principles of *Goltra*, *Thayer-West Point Hotel*, *Angarica*, and *Ramsey* above, indicate that the same no-interest rule applies to *any* incremental *damages* sought to be assessed against the United States, whether it be designated interest, as such, or is designated by some other terminology which has the same effect.

*See Pawnee Indian Tribe of Oklahoma* v. *United States*, 157 Ct. Cl. 134, 137, 140, 301 F. 2d 667, 668–70, *cert. denied*, 370 U.S. 918 (1962), where the Commission was reversed for permitting only the present worth of the defendant's consideration payments because this would be tantamount to charging the United States interest. *See also United States* v. *Delaware Tribe*, 192 Ct. Cl. 385, 427 F. 2d 1218 (1970), where the Commission had applied an annual reduction to the Government's offset claims, but this court reversed noting that:

> * * * We conclude that even if it could be said that the $72,600.37 was not interest per se or interest in the strict sense of the word, the act of the Commission in denying this amount as offsets solely by reason of its five percent rule had the effect of granting interest on the award. We do not believe the Commission can do indirectly what it is prohibited from doing directly. [*Id.* at 394, 427 F. 2d at 1223.]

*Also see United States* v. *Nez Perce Tribe of Indians*, 194 Ct. Cl. 490, 494–499, *cert. denied*, 404 U.S. 872 (1971), where the court, in reversing the Commission, pointed out that *Peoria Tribe* v. *United States*, *supra*, did not change the usual rule that absent a breach of a specific treaty obligation, no interest, or its equivalent, can be allowed against the United States.

It may be seen from the foregoing decisions that the character or nature of "interest" cannot be changed by calling it "damages," "loss," "earned increment," "just compensation," "discount," "offset," or "penalty," or any other term, because it is still interest and the no-interest rule applies to it*

The Commission is not consistent in its reasoning. It devoted much of its 123 page decision to a discussion of why the Indians were entitled to an award of interest against the United States, including the following statement, among others:

> * * * We are not here awarding *interest* on a judgment for *simple interest*, but including an additional factor

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*Former Chief Judge Jones observed in *Union Pacific RR Co.* v. *United States*, 117 Ct. Cl. 534, 91 F. Supp. 762 (1950) that calling a billy goat a horse did not make him one.

> in our judgment to make up for the income which should have been, but was not, earned on reinvested *interest.*
>
> The only practical way we can think of to assess *damages* for failure to comply with the law requiring investment and reinvestment of the income *is by awarding compound interest.* [Emphasis supplied.] [31 Ind. Cl. Comm. 427, 529.]

This statement obviously means the Commission awarded both simple and compound interest against the Government. The clear meaning of the decision considered as a whole shows this to be true. In this regard, it is significant that Commissioner Vance was not the slightest bit evasive and minced no words as to his understanding of the award the Commission was making when he stated in his concurring opinion:

> Equity and good conscience, dominant principles in these accounting cases, as well as the plain language of the 1841 act, *compel us to award compound interest.* [Emphasis supplied.] [31 Ind. Cl. Comm. 427, 550.]

Yet the Commission says on the other hand it is not awarding interest but damages. See 31 Ind. Cl. Comm. 427, 527 where the Commission said:

> In awarding *damages* equal to compound interest * * * for the period between 1883 * * * and ending June 30, 1930, * * *.
>
> * * * [W]e have the authority, and duty, to award *damages* for breach of the 1841 act, *which damages are measured by interest.* * * * [Emphasis supplied.]

Although the Commission speaks of awarding damages, it is clear that it awarded interest, and that this was done principally on the basis of an Act of Congress of 1841, which will be discussed below. Yet we find the astonishing statement of the Commission in its order overruling the motion for rehearing of the Te-Moaks, 33 Ind. Cl. Comm. 417, 424:

> *The 1841 act does not authorize us to award interest against the Government.* * * * [Emphasis supplied.]

Commissioner Vance signed this order as one of the three who made up the majority of the Commission. This statement is diametrically opposed to the statement in his concurring opinion quoted above.

This switching back and forth from an award of interest to damages and back to interest by the Commission would lead one to believe the Commission was well aware that under the law and the facts of this case it had neither jurisdiction nor authority to allow interest on the claim of the Indians against the United States, but concluded that it would be right or just for the Indians to receive the interest. This court was reversed by the Supreme Court for awarding interest against the Government on exactly the same basis in *United States* v. *N. Y. Rayon Importing Co.*, 329 U.S. 654 (1947). There the Supreme Court said:

> The Court of Claims, * * * sought to justify its award of interest on what it thought "*would be right or just.*" * * *
>
> But assuming that the *equities* of the situation all favor the owners of the refund claims, the Court of Claims did not thereby acquire power to carve out an implied exception to the plain words of § 177(a). Had Congress desired to permit the recovery of interest in situations where the Court of Claims felt it *just or equitable*, it could have so provided. The absence of such a provision is conclusive evidence that the court lacks any power of that nature. Indeed, *any other conclusion would permit the Court of Claims to supply the consent which only Congress can give to the imposition of interest against the United States.* [Emphasis supplied.] [*Id.* at 659–60.]

Obviously, the same reasoning applies to the lack of power of the Commission to award interest, unless the requirements of the no-interest rule are met. *See also United States* v. *Omaha Tribe of Indians*, 253 U.S. 275, 283 (1920), in which the Supreme Court held that the rule of *equity* would not take the case out of the usual no-interest rule even though the jurisdictional act called for a consideration of both *equitable* and legal claims. No matter how high the purpose or how benevolent the motive, neither this court nor the Commission can award interest against the Government unless the requirements of the no-interest rule have been met. *See also Loyal Band of Creek Indians* v. *United States*, 118 Ct. Cl. 373, 382–83, 97 F. Supp. 426, 431, *cert. denied*, 342 U.S. 813 (1951).

In any event, we hold that the order of the Commission was an award of simple and compound interest on the claim of the Indians against the United States. This award was contrary to law, as shown by the foregoing authorities, unless there was a contract, treaty, or agreement between the Indians and the United States or an Act of Congress expressly providing for the payment of interest. Neither the Indians nor the Commission contend that a contract, treaty or agreement existed that provided for the payment of interest. Therefore, the sole question is whether there was any statute or other Act of Congress that expressly required the interest payment.

The Indians and the Commission contend that there were two statutes that required or at least authorized the award of interest in this case. These statutes were: (1) The Act of September 11, 1841, ch. 25, 5 Stat. 465, and (2) the Indian Claims Commission Act of August 13, 1946, 25 U.S.C. § 70a (1970). We will first consider the 1841 Act upon which the Indians and the Commission principally rely, which reads as follows:

> Chap. XXV.—*An Act to repeal a part of the sixth section of the act, entitled "An act to provide for the support of the Military Academy of the United States for the year eighteen hundred and thirty-eight, and for other purposes," passed July seventh, eighteen hundred and thirty-eight.*
>
> *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled*, That so much of the sixth section of an act entitled, "An act to provide for the support of the Military Academy of the United States for the year eighteen hundred and thirty-eight, and for other purposes," as requires the Secretary of the Treasury to invest the anual interest accruing on the investment of the money arising from the bequest of the late James Smithson, of London, in the stocks of States, be, and the same is hereby, repealed. And the Secretary of the Treasury shall, until Congress shall appropriate said accruing interest to the purposes prescribed by the testator for the increase and diffusion of knowledge among men, invest said accruing interest in any stock of the United States bearing a rate of interest not less than five per centum per annum.

> SEC. 2. *And be it further enacted*, That all other funds held in trust by the United States, and the annual interest accruing thereon, when not otherwise required by treaty, shall in like manner be invested in stocks of the United States, bearing a like rate of interest.
>
> SEC. 3. *And be it further enacted*, That the three clerks, authorized by the act of June twenty-third, eighteen hundred and thirty-six, "to regulate the deposits of the public money," be, and hereby are, directed to be retained and employed in the Treasury Department, as provided in said act, until the state of the public business becomes such that their services can conveniently be dispensed with.

The reliance by the Indians and the Commission on the 1841 Act as authority for the award of simple and compound interest on I.M.P.L. Funds is misplaced. In the first place, the Act did not expressly require the Government to pay interest to Indian tribes or to anyone else. It was merely a directive to the appropriate officers of the Government holding trust funds that were *required* by treaty, contract, or statute to be invested, to invest them *only* in stocks of the United States, bearing interest at not less than five percent per annum. The primary purpose of the Act was to prevent any future investment of trust funds in state stocks or bonds. Thus the Act did not create any obligation on the Government to pay interest on trust funds, but only provided *where* they must be invested if any statute or treaty required them to be productive. The reason for the passage of the Act and its purpose can be better understood by a brief consideration of the economic and financial conditions that existed in the country immediately prior to and at the time of its enactment.

On January 9, 1837, Congress enacted a statute (5 Stat. 135) that provided that the proceeds from lands ceded by Indians to the United States should be paid into the Treasury and if the treaties required them to be invested, such investments were to be made under the direction of the President. By 1838 there were 13 Indian trust funds in this category and all of them were invested in state bonds. However, soon after the 1837 Act was passed, a severe economic depression occurred throughout the Nation (called a panic in those days), and within a matter of weeks after the passage of the Act most banks suspended specie payments. Many states defaulted on their bonds including Tennessee, Alabama, Mississippi, and Maryland. This depression was still going on in 1841 and afterwards.

It was against this background that Congress considered changing the law that would allow trust funds to be invested in state bonds, because Congress was genuinely concerned about the default of the states on their bonds. Congressman John Quincy Adams (formerly President Adams) introduced a resolution in the Congress providing:

> That the further investment of any public funds of the United States in stocks of the several states ought forthwith to be prohibited by law.[2]

Because of the depression (panic), the default by various states on their bonds, and the deep concern of Congress with reference to Government trust funds that were invested in state bonds, the Congress enacted the Act of 1841. The sole purpose of the Act was to prohibit future investment of trust funds, that were required to be invested, in state bonds, and to accomplish this purpose the Act required such funds to be invested in bonds of the United States.

At the time the Act was passed in 1841 there were very few I.M.P.L. Funds in existence and those that did exist were in the hands of local Government agents for use by them for the benefit of Indians on a day to day basis. None of these funds were on deposit in the Treasury at that time. The Congress could not have intended that the 1841 Act apply to I.M.P.L. Funds because they scarcely existed, were not in the Treasury, and were not capable of being invested.

Furthermore, in 1841 there were 28 Indian funds held in trust by the Government, all of which had been specifically designated as productive by Congress, or the President had been given authority by Congress to invest them. These were the funds which the Act required to be invested in United States bonds and their investment in state bonds was prohibited.

During the years from 1841 to 1930, no one in the Executive Department of the Government considered the 1841 statute as authority to invest Indian trust funds nor as a law requiring the Government to pay interest on such funds. Subsequent to 1841, the Government continued to make treaties with Indians and enacted statutes in which Indian funds created thereby were required to be invested. These funds were invested according to the provisions of these later treaties and statutes. Not once in 130 years was the 1841 statute cited as authority to invest Indian trust funds that were required to be made productive by treaties or statutes made or enacted after 1841. This long administrative practice by the Executive Department charged with handling and investing Indian trust funds, which was concurred in by Congress, is entitled to great weight in determining the intent of Congress when it enacted the 1841 statute. In this regard, the Supreme Court held in *United States* v. *Jackson*, 280 U.S. 183 (1930):

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[2] Cong. Globe, Sept. 1, 1841 (B-3).

> It is a familiar rule of statutory construction that great weight is properly to be given to the construction consistently given to a statute by the Executive Department charged with its administration. *United States* v. *Cerecedo Hermanos y Compania*, 209 U.S. 337; *Robertson* v. *Downing*, 127 U.S. 607; *United States* v. *Healey*, 160 U.S. 136; and such construction is not to be overturned unless clearly wrong, or unless a different construction is plainly required. * * * [*Id.* at 193.]

During the more than 130 years the 1841 statute has been in existence, no court that we know of has allowed interest on a claim against the United States in a non-eminent domain case unless there was a contract, treaty, or statute (other than the 1841 statute) that expressly provided for interest. Every case we have cited in this opinion denying interest has been decided since the 1841 Act was passed. During this long period of time it has been the universally accepted rule that the requirements of the no-interest rule be met if interest is to be allowed. For instance, in the dissenting opinion of Judge Davis, concurred in by Judge Durfee, of our court in *Peoria Tribe of Indians* v. *United States*, 177 Ct. Cl. 762, 369 F. 2d 1001 (1966), *rev'd*, 390 U.S. 468 (1968), he stated:

> I join in the court's opinion on the first claim, but dissent from the disposition of the *demand for interest*

> on the $172,762.04 awarded by the Indian Claims Commission.
>
> The sole ground for this claim is Article 7 of the 1854 Treaty, 10 Stat. 1084, which provided:
>
> > And as the amount of the annual receipts from the sales of their lands, cannot now be ascertained, it is agreed that the President may, from time to time, and upon consultation with said Indians, determine how much of the net proceeds of said sales shall be paid them, and how much shall be invested in safe and profitable stocks, the interest to be annually paid to them, or expended for their benefit and improvement.
>
> *It is agreed that if this is read as containing an express provision for interest appellants can recover, otherwise not.* See *United States* v. *Alcea Band of Tillamooks*, 341 U.S. 48, 49 (1951); *Confederated Salish and Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451, 454 (1966), *cert. denied*, 385 U.S. 921. * * * [Emphasis supplied.] [*Id.* at 770–71, 369 F. 2d at 1006.]

At that time the 1841 statute had been in existence for over 125 years, but no attention was paid to it. The above statement was a correct one, but it would not have been correct if the 1841 Act required the payment of interest as the Indians contend in the instant case.

During the long period of time that the 1841 statute has been on the books, no court that has considered it has held that the Act required the Government to pay interest on any trust fund unless there was a contract, treaty, or statute (other than the 1841 Act) requiring the payment of interest.

The case of *United States ex rel. Angarica* v. *Bayard*, 4 Mackey 310 (D.C. Sup. Ct. 1885), *aff'd*, 127 U.S. 251 (1888), standing alone is sufficient authority to overturn the decision of the Commission in the instant case. In that case the Government collected a sum of money in arbitration proceedings from Spain for plaintiff Angarica for injuries and damages caused to her by Spain while in Cuba. The Government paid all of the money to Angarica except $41,129.74, which is retained and invested until such time as Spain paid the expenses of arbitration. When Spain paid these expenses, the Government paid the $41,129.74 to Angarica but did not pay her the interest it had earned. She sued for the interest, claiming that the 1841 statute (involved in the instant suit) required the Government to pay her the interest. The Supreme Court of the District of Columbia, after quoting the 1841 statute, stated:

> * * * At the time of the enactment of 1841 there existed certain treaties with the Indians, containing stipulations for the payment to them, annually, of interest upon the proceeds of lands ceded by them; and it had already been provided by the act of January 9, 1837 (5 Stat., 135), which is now embodied in the Revised Statutes as section 2096, that these funds should be invested in securities at not less than five percent interest. *It was clearly for trusts of this definite character, established as we have said, by law, that the act of 1841 proposed to establish a general system.* This is especially indicated by the exception in that act of cases regulated by treaty. The reference is to these Indian treaty funds. *We think, then, that the statute did not apply to the transaction in question*, and it is evident that the executive did not propose to conform to its requirements. [Emphasis supplied.] [*Id.* at 324.]

The court denied Angarica's suit for interest and dismissed her petition. It is clear from the above statement of the court that the 1841 Act as regards Indian trust funds was limited to "certain treaties with the Indians, containing stipulations for the payment to them annually of interest upon the proceeds of lands ceded by them," and that "it was clearly for trusts of this definite character, established * * * by law" that the Act of 1841 applied, and not otherwise.

The Supreme Court affirmed the *Angarica* case in 127 U.S. 251 (1888). In its opinion the Court said:

> * * * It has been established, as a general rule, in the practice of the government, that interest is not allowed on claims against it, whether * * * they arise in the ordinary business of administration or under private acts of relief, * * *. [*Id.* at 260.]

In support of this statement, the Court cited eleven opinions of the Attorney General: 1, 268; 1, 550; 1, 554; 3, 635; 4, 14; 4, 136; 4, 286; 5, 105; 7, 523; 9, 57; and 9, 449. The Court went on to say:

> Not only is this the general principle and settled rule of the executive department of the government, but it

> has been the rule of the legislative department, because Congress though well knowing the rule observed at the Treasury, and frequently invited to change it, has refused to pass any general law for the allowance and payment of interest on claims against the government. * * * [*Id.* at 260.]

It is particularly significant that the Supreme Court stated that Congress well knew the general rule of no-interest on claims against the Government and had been invited frequently to change it, but had refused to do so. At that time (1888) the 1841 statute had been in existence for 47 years. The law was definitely established by this decision of the Supreme Court that the 1841 Act applied only to funds created by a treaty or by a specific statute requiring the payment of interest. The decision of the Commission in the instant case is in direct conflict with the decisions of the Supreme Court of the District of Columbia and of the Supreme Court in the *Angarica* case.

But we do not have to stop here. Other courts have considered the 1841 statute and have handed down decisions which directly conflict with the decision of the Commission in this case. In *Omaha Tribe of Indians* v. *United States*, 53 Ct. Cl. 549 (1918), *rev'd in part and aff'd in part*, 253 U.S. 275 (1920), the court awarded judgment to the Indians for $18,202.19 representing default by two Government agents in disbursing treaty funds, but did not award interest on the claim. On appeal to the Supreme Court the Indians sought to recover the interest, quoting the 1841 statute and making essentially the same arguments made by the Indians and the Commission in the instant case.[8] However, the Supreme Court rejected the arguments of the Omahas and refused to allow them interest. This decision was handed down 30 years after the *Angarica* decision, but to the same effect. The 1841 statute had been in existence for 77 years at this time (1918).

In *Cherokee Nation* v. *United States*, 270 U.S. 476 (1926), the Supreme Court refused to grant interest on interest although the Cherokees urged that it do so on the basis of the 1841 statute. In that case the Supreme Court said:

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[8] See Omaha Brief, Record and Briefs in U.S. cases, U.S. Supreme Court, October 1919 Term, Vol. 29, Dept. of Justice Library.

> When we consider the rule requiring an express provision of contract or statute to justify the imposition of interest in adjudicating any claim against the United States, we can find nothing in the circumstances of this case to increase the interest as adjudged. * * * The only contractual obligation here is for simple five percent. interest until payment.
>
> * * * * *
>
> And by § 3659 of the Revised Statutes, re-enacting § 2 of the Act of Congress of September 11, 1841, 5 Stat. 465, which provides:
>
> "All funds held in trust by the United States, and the annual interest accruing thereon, when not otherwise required by treaty, shall be invested in stocks of the United States, bearing a rate of interest not less than five per centum per annum."
>
> It is urged that the largest item, of $1,111,284.70, was taken out of a $5,000,000 trust fund held by the United States for the benefit of the Cherokees, and therefore that it should be treated as if it were always in the Treasury of the United States, held in trust for the Indians, and as if the United States had collected the interest thereon out of the invested stocks and had refused to pay it over as annuities to the Indians. *This claim proves too much. It would require compound interest brought about by annual or semi-annual rests for near a century, an amount that the Solicitor General suggests would be equal to the National debt.* The argument is shown to be wholly without support in the circumstance that the Cherokees and the United States, by the resolution of the Senate in 1850, agreed upon the interest for such debts as that of five per cent. until paid. * * * [Emphasis supplied.] [*Id.* at 490, 492.]

It is to be observed that the Supreme Court was well aware of the provisions of the Act of 1841. Also, it should be pointed out that the 1841 Act speaks of simple interest as well as interest on interest (compound interest). Here we find the Supreme Court holding in no uncertain terms that the 1841 Act does not require compound interest to be paid *because* the *treaty* only *required* simple interest at five percent. At the time of this decision (1926) the 1841 Act had been in existence for 85 years. It cannot be said that the Supreme

Court was ignorant of its existence or of its provisions because it is quoted in the Court's opinion. Under these circumstances, it is especially significant that the Court recognizes and repeats the no-interest rule in its opinion when it said "When we consider the rule requiring an *express provision of contract or statute* to justify the imposition of interest in adjudicating any claim against the United States * * *. The only *contractual obligation here* is for simple five per cent. interest * * *." [Emphasis supplied.] [270 U.S. at 490.] It must be concluded that the decision of the Commission is in direct conflict with the *Cherokee* decision, because if the 1841 Act does not require the payment of compound interest by the United States in the absence of a treaty or statute so providing, as the Supreme Court holds, by the same rule simple interest would not be required to be paid under like circumstances, either. The Commission erred in allowing simple interest, as well as compound interest, under the 1841 statute in this case.

In *United States* v. *Blackfeather*, 155 U.S. 180, 192 (1894), the 1841 statute is mentioned in passing, but the Court allowed five percent interest because a treaty in that case required it to be paid and not because of the 1841 statute. A similar result occurred in *Ottawa & Chippewa Indians* v. *United States*, 42 Ct. Cl. 240 (1907). In that case the court noticed the 1841 Act but awarded simple interest at five percent only because the treaty in that case expressly required it. Thus, it can be seen that *Blackfeather* and *Ottawa & Chippewa Indians* are within an exception to the no-interest rule and are of no help to the Indians or the Commission in the instant case.

The only other case we have found that considers the 1841 Act is our own decision in *Bonnar* v. *United States*, 194 Ct. Cl. 103, 438 F. 2d 540 (1971). In that case the alien property custodian had seized and sold property under the Trading with the Enemy Act, 50 U.S.C. App. § 9(a) (1970) during the second world war and held the proceeds in trust without investing it. After the war the owners sued for and were given a judgment for the proceeds of the sale of their property. They also claimed interest on such proceeds under the 1841 Act, now codified as 31 U.S.C. § 547(a), but we denied them a recovery of the interest. As to the interest, we held in an opinion written by Judge Durfee of our court as follows:

> Plaintiffs' final argument for interest requires us to consider the 1962 amendment to § 9(a) of the Act which directs that the proceeds of sale "shall be held *in trust* by the Secretary of the Treasury", * * * [Emphasis by Judge Durfee] 50 U.S.C. App. § 9(a) (1964), in conjunction with 31 U.S.C. § 547(a) (1964), which provides:
>
> > *All funds held in trust* by the United States, and the annual interest accruing thereon, when not otherwise required by treaty, *shall be invested* in stocks of the United States, bearing a rate of interest not less than 5 per centum per annum. [Emphasis by Judge Durfee.]
>
> From these statutes and some familiar principles of trust law regarding the obligation of a trustee to invest trust funds (see Restatement, 2d, Trusts, § 181), plaintiffs' counsel conclude that the Government has been under a duty to invest the sales proceeds in question, and that, if the Government has not done so, then it has been enjoying "the economic benefits of an interest-free loan." *To this argument, we have two responses. First, § 9(a) of the Act could have specifically referred to 31 U.S.C. § 547(a), or required the Treasurer to invest the proceeds of any sale or liquidation. However, that section makes no such reference, and we regard this as a strong indication that Congress intended to limit recovery to the allocated sales proceeds.* [Emphasis supplied.] Second, and most importantly, this question was carefully considered in *Gmo, Niehaus & Co.* v. *United States*, 179 Ct. Cl. 232, 373 F. 2d 944 (1967), which was decided after the Act was amended in 1962, and it was answered adversely to plaintiffs' contentions. *Niehaus* involved the recovery of damages by plaintiffs on a claim for the value of money or property unlawfully appropriated by vesting under the Trading With the Enemy Act. Particularly pertinent is the court's discussion of defendant's liability for any post-sale increment. In that regard, the court stated:
>
> > In this connection, it should be noted that Section 7(c) of the Trading With the Enemy Act, as amended (50 U.S.C. App. § 7(c) (1964)), provides that in a case involving the unlawful vesting and the subsequent sale by the Alien Property Custodian

> > of the property of a person who was not an enemy national, any recovery by the owner of the property "shall be limited to and enforced against the net proceeds received therefrom and held by the Alien Property Custodian or by the Treasurer of the United States." * * * Although this limitation of the Trading With the Enemy Act may not be strictly applicable in terms to plaintiffs' case, we should be governed by *its indication of the Congressional policy as to maximum recovery. Neither the post-sale increment in value nor interest is recoverable under Section 7(c), and neither should be recoverable here.* [Emphasis by Judge Durfee.] *Cf. Sac & Fox Tribe of Indians of Oklahoma* v. *United States*, decided this day, Part VI of that opinion, *ante*, p. 24.
> >
> > * * * * *
> >
> > * * * *In non-eminent domain cases, the normal rule is that interest is not recoverable unless authorized by statute or contract, 28 U.S.C. § 2516(a). In this instance there is neither statutory nor contractual authorization.* [Emphasis supplied.] *On the contrary, Section 7(c) of the Trading With the Enemy Act looks the other way.* [Emphasis by Judge Durfee.] [179 Ct. Cl. at 262–63, 373 F. 2d 961–62.]
>
> Plaintiffs allude to certain factual differences between *Niehaus* and the instant case, but none dilute the full force and effect of the court's general interpretation of § 7(c) of the Act.
>
> In the absence of compelling evidence to the contrary, we must always be guided by the Congressional intent which, in this instance, is clearly that *the Government must specifically consent to be liable for interest in express terms, rather than by implication*, except in the most extreme cases, such as *Henkels*, in which an alternate approach is desirable and necessary to avoid a serious inequity, *i.e.*, unjust enrichment. Therefore *plaintiffs are not entitled to interest on the allocated sales proceeds of their shares of GDC stock.* [Emphasis supplied.] [194 Ct. Cl. at 163–64, 438 F. 2d at 572–73.]

As applied to the instant case, the first reason we gave in *Bonnar* for denying interest could be paraphrased with reference to the 1883 Act, which placed the I.M.P.L. Funds in the instant case in trust in the Treasury for the first time, as follows:

> The 1883 Act could have specifically referred to the

> 1841 Act, or required the Treasurer to invest the I.M.P.L. Funds. However, the 1883 Act makes no such reference, and we regard this as a strong indication that Congress intended that the Indians would receive only the amount of the I.M.P.L. Funds deposited in the Treasury.

Our holding in that case that "the Government must specifically consent to be liable for interest in express terms, rather than by implication" is very significant. We were, of course, saying that the efforts of the plaintiff to recover interest on the theory that it was allowed *by implication* under the 1841 statute would not be approved. The courts have held over and over again, as shown by the decisions cited above, that interest on a claim against the Government will not be allowed *by implication* but must be expressly provided for in a treaty or statute. The decision in *Bonnar* is squarely against the Indians' claim for interest in this case, and the order of the Commission allowing interest is in direct conflict with that decision.

In the foregoing paragraphs, we have reviewed every case we have been able to find that has mentioned, noticed or considered interest on claims against the Government under the 1841 statute. All of them that have passed on the meaning of the Act have denied claims for interest such as those asserted by the Indians on I.M.P.L. Funds in this case.

One other case should be mentioned, although it does not involve the 1841 statute, it does contain a claim for interest on I.M.P.L. Funds as in the instant case. We refer to the case of *Creek Nation* v. *United States*, 78 Ct. Cl. 474 (1933). In that case the Creeks recovered a judgment against the Government for $144,106.01. They claimed interest in the sum of $1,401,195.01. The facts showed that the Creeks claimed interest on the funds that were carried on the books of the Treasury as follows: (1) General Creek fund, (2) Interest on General Creek fund, (3) I.M.P.L. Funds, and (4) Interest on Creek moneys on deposit in banks. There was a treaty with the Creeks that required the payment of interest on the "General Creek Fund," but not on the other funds. The Creeks contended that the I.M.P.L. Funds should have been placed in the "General Creek Fund" and interest paid thereon. The court rejected this theory and denied interest on the I.M.P.L. Funds, saying:

> * * * Moneys arising from the sources stated [IMPL funds] clearly could not be credited to the interest-bearing "Creek general fund." * * * There being no treaty or statutory obligation on the part of the United States to pay interest on Creek tribal funds, [including IMPL funds] other than those belonging to the "Creek general fund", interest can be allowed only on such of the unauthorized disbursements as were made from that fund. [*Id.* at 505.]

Based on the facts described above and the court decisions we have cited, we hold that the purpose of the 1841 statute was to prohibit investment of United States trust funds, that were required by treaty or statute to be productive, in state bonds and to require them to be invested in United States securities, and that the Act did not require the payment by the United States of interest on any fund that was not expressly required to be productive by a contract, treaty, or statute. Consequently, the Indians in the instant case are not entitled to recover interest from the Government on their I.M.P.L. Funds. The 1841 statute simply does not apply to the I.M.P.L. Funds involved in the instant case. The statute is a rather obscure one, having been enacted over 133 years ago, and during that long period of time no administrative officer of the Government has ever allowed or paid interest because of its provisions, nor has any court ever allowed interest on a claim against the Government because of it. The statute was directory only as to where trust funds that were otherwise required to be made productive could be invested.

The Commission is clearly in error in awarding compound interest in this case. Even when simple interest is required to be paid by treaty or statute, all of the cases hold that compound interest cannot be allowed against the Government. In *Menominee Tribe of Indians* v. *United States*, 97 Ct. Cl. 158, 162 (1942) we held:

> It is well settled that the United States cannot be charged with interest except where liability therefor is clearly imposed by the statute or assumed by contract. *United States* v. *North Carolina*, 136 U.S. 211; *Cherokee*

*Nation* v. *United States*, 270 U.S. 476; *United States* v. *Worley, Administratrix, et al.*, 281 U.S. 339; *The Ute Indians* v. *United States*, 45 C. Cls. 440, 470. In *Cherokee Nation* v. *United States*, *supra*, the court said, at pp. 490, 491:

> In view of the care with which Congress and this Court in interpretation of the legislative will, have limited the collection of simple interest against the Government, *a fortiori* must compound interest be denied to appellant unless provision therefor is made in the contract of 1891, or in the statute of 1919 authorizing this suit, and it is to be found in neither.

The cases cited make it clear that a statute consenting to payment of interest refers to simple interest only, and *any obligation to pay compound interest cannot be implied from general words, but must be based upon clear and unequivocal language leaving no doubt as to the intention of Congress to depart from the general rule so announced as to the right to charge and collect interest from the Government.* The Act of February 12, 1929, *expressly provided for only "simple interest"* upon money held in trust fund accounts, and *this language may not be interpreted as intending to obligate the United States to pay interest upon interest* previously credited upon other interest-bearing funds or accounts. The term "simple interest" has a well-established meaning. [Emphasis supplied.]

In that case we held further:

> We are of opinion that plaintiff is not entitled under the provisions of the Act of February 12, 1929, to recover interest on interest. * * * [*Id.* at 161.]

In *Ute Indians* v. *United States*, 45 Ct. Cl. 440, 470 (1910) we held that compound interest could not be allowed against the Government:

> No interest, either simple or compound, can be collected from a sovereign except by its consent. (*United States* v. *North Carolina*, 136 U.S. 211.) In the case at bar the sovereign has agreed to pay interest, and that means simple interest only. But the plaintiffs seek to charge the defendants with compound interest in this case on the ground that the money so received constituted a trust fund, and that in such cases where the fund has been improperly withheld, the trustee is penalized with compound interest. It is elementary as a general proposition, in the absence of a contract to that effect,

> that interest upon interest is not recoverable for the detention of money, and that is a general rule either at law or equity. (*Perley on Law of Interest*, 159, 160; *In re Ward's estate*, 73 Mich., 220, 228.) It is only where a trustee, guardian, or executor has acted in bad faith, in abuse of his trust or has been guilty of such gross negligence as to be evidence of a corrupt intention, that compound interest will be charged against him (*Barney v. Saunders*, 16 How., 535; *Perrin* v. *Leper*, 72 Mich., 446; *Vaughan* v. *Bibb*, 46 Ala., 153; *Smith* v. *Kennard*, 38 Ala., 695).
>
> *The Government* only acts through its officers and agents and thus in law can never be guilty of fraud, bad faith, or negligence; *hence it can never be penalized by being charged compound interest.* [Emphasis supplied.]

In the case of *Peoria Tribe* v. *United States*, 390 U.S. 468 (1968), the Supreme Court held that compound interest could not be allowed against the Government without its consent, saying:

> Because the United States is not liable for interest on judgments in the absence of an express consent thereto, it cannot be liable for interest on the annual income payments not made. Therefore, if an interest rate measure is adopted by the Commission, it must be simple and not compound interest. [*Id.* at 473 n. 6.]

The Supreme Court held in *Cherokee Nation* v. *United States*, 270 U.S. 476 (1926) that compound interest against the Government must be denied unless provision is made therefor in a contract or statute, saying:

> * * * The only contractual obligation here is for simple five per cent. interest until payment.
>
> What the appellant here seeks is compound interest, that is interest on interest from 1895 until now. The general rule even as between private persons is that in the absence of a contract therefor or some statute, compound interest is not allowed to be computed upon a debt. *Whitcomb* v. *Harris*, 90 Me. 206; *Bradley* v. *Merrill*, 91 Me. 340; *Ellis* v. *Sullivan*, 241 Mass. 60, 64; *Tisbury* v. *Vineyard Haven Water Company*, 193 Mass. 196; *Lewin* v. *Folsom*, 171 Mass. 188, 192; *Wallace* v. *Glaser*, 82 Mich. 190; *Blanchard* v. *Dominion National Bank*, 130 Va. 633, 637; *Finger* v. *McCaughey*, 114 Cal. 64, 66; *Cullen* v. *Whitham*, 33 Wash. 366, 368. In view of the care with which Congress, and this Court in inter-

> pretation of the legislative will, have limited the collection of simple interest against the Government, *a fortiori* must compound interest be denied to appellant unless provision therefor is made in the contract of 1891, or in the statute of 1919 authorizing this suit, and it is to be found in neither. [*Id.* at 490–91.]

*See also Creek Nation* v. *United States*, *supra*, and *United States* v. *Blackfeather*, *supra*. All of the cases hold that even where a treaty or statute require the payment of interest, only simple interest is intended and compound interest cannot be awarded against the Government.

The Commission asserts that aside from the 1841 statute, the Indian Claims Commission Act authorizes it to award simple interest and compound interest to the Indians against the Government in this case. We do not agree. The Indian Claims Commission Act nowhere authorizes the Commission to award any kind of interest against the Government. All of the cases that have considered the question have ruled the other way. *See Osage Nation of Indians* v. *United States*, 119 Ct. Cl. 592, 671–72, 97 F. Supp. 381, 424–25, *cert. denied*, 342 U.S. 896 (1951); *Kiowa, Comanche & Apache Tribes* v. *United States*, 143 Ct. Cl. 534, 543–44, 163 F. Supp. 603, 609–10 (1958); *Blackfeet & Gros Ventre Tribes* v. *United States*, 2 Ind. Cl. Comm. 302, 314 (1952), *aff'd*, 127 Ct. Cl. 807, 119 F. Supp. 161, *cert. denied*, 348 U.S. 835 (1954); *Nez Perce Tribe of Indians* v. *United States*, 194 Ct. Cl. 490, 499, *cert. denied*, 404 U.S. 872 (1971); and *Loyal Band of Creek Indians* v. *United States*, 118 Ct. Cl. 373, 382–83, 97 F. Supp. 426, 431, *cert. denied*, 342 U.S. 813 (1951).

We hold that the Indian Claims Commission Act does not authorize the Commission to award simple interest or compound interest on a claim against the Government in any non-eminent domain case unless a contract, treaty, or statute expressly provides for the payment of such interest; and that there is no such contract, treaty, or statute in the instant case.

The serious consequences of the decision of the Commission in this case which allows simple interest and compound interest to the Indians against the Government on their claims from 1883 to 1930 on the basis of the 1841 statute cannot be overemphasized. The decision would open the doors to claims for simple and compound interest of beneficiaries of every trust fund, Indian and otherwise, held by the United States from 1841 to 1975, or until payment, and the ultimate cost to the Government could be an astronomical amount. The Government estimates it could amount to billions of dollars. We have no way of determining whether or not this is correct, but it stands to reason that the potential cost of the decision would be tremendous. This possible enormous cost to the Government is naturally of great concern to this court, although it does not govern the outcome of this suit. Nevertheless, it has caused us to consider the decision of the Commission with great care.

As stated in the beginning of this opinion, the Te-Moaks claimed that they should be awarded interest on shortages in fulfillment of the Government's obligations under the Treaty of October 1, 1863, 18 Stat. 689. The Commission correctly treated these shortages in payments as breaches of contractual obligations rather than as breaches of trust and denied interest on the shortages. *See United States* v. *Omaha Indians*, 253 U.S. 275 (1920), *aff'g in part*, *rev'g in part*, 53 Ct. Cl. 549 (1918); *Confederate Salish & Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451, *cert. denied*, 385 U.S. 921 (1966); *Rogue River Tribe of Indians* v. *United States*, 105 Ct. Cl. 495, 552–53, 64 F. Supp. 339, 344 (1946); *Choctaw Nation* v. *United States*, 91 Ct. Cl. 320, 402 (1940), *cert. denied*, 312 U.S. 695 (1941); *Tillson* v. *United States*, 100 U.S. 43, 47 (1879); *Ramsey* v. *United States*, 121 Ct. Cl. 426, 431–32, 101 F. Supp. 353, 356 (1951), *cert. denied*, 343 U.S. 977 (1952); *Peoria Tribe of Indians*, 177 Ct. Cl. 762, 369 F. 2d 1001 (1966), *rev'd on other grounds*, 390 U.S. 468 (1968); and decision of the Comptroller General, A–27308 of May 31, 1929. In this connection, we held in *Confederated Salish & Kootenai Tribes* v. *United States*, *supra:*

> * * * The taking away of *contractual rights*, via a rupture of the contract, is of course not equivalent to a taking of *property* under the Fifth Amendment. It is commonplace for the defendant to be held in this court for having gone back on a promise and thus denied a plaintiff his rights. *Interest is not paid on an award of that kind for a breach of contract. Choctaw Nation* v. *United States*, 91 Ct. Cl. 320, 402–03 (1940), *cert. denied*,

> 312 U.S. 695 (1941). * * * [Footnote omitted.] [Emphasis supplied.] [175 Ct. Cl. at 455.]

Again in *Peoria Tribe of Indians* v. *United States*, *supra*, we held:

> Admittedly no interest is allowable for the breach of an obligation to pay over money to the Indians. *Confederated Salish and Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451 (1966), *cert. denied*, 385 U.S. 921 and *Ramsey* v. *United States*, 121 Ct. Cl. 426, 431–32, 101 F. Supp. 353 (1951), *cert. denied*, 343 U.S. 977 (1952). * * * [177 Ct. Cl. at 770 n. 9, 369 F. 2d. at 1006.]

The Commission was correct in denying the Te-Moaks interest on the treaty shortages, and its decision in that regard should be affirmed.

Accordingly, the decision and order of the Commission awarding simple interest and compound interest, whether called interest or damages, to the appellee Indian tribes on I.M.P.L. Funds from 1883 to 1930 is reversed.

The decision and order of the Commission denying the claim of the Te-Moaks, cross-appellants, for interest on shortages in payment by the Government of its obligations under the Treaty of October 1, 1863, is affirmed.

The case is remanded to the Indian Claims Commission for further proceedings in accordance with this opinion.

*Affirmed in part,*
*reversed in part,*
*and remanded.*

NICHOLS, *Judge*, concurring:

I concur in the result. The opinion accepts without question the Government's explanation of the 1841 Act. Though an air of certainty in a judicial opinion is a desirable quality, in this instance I deem it overdone. I believe reasonable persons can differ, as they have. On the other hand, the dissent would fasten on the Government the duties and obligations of a testamentary trustee with respect to all Indian funds it collected, managed, and disbursed prior to 1930. That role resembles in some respects that of a trustee, but it also looks like that of a banker. Unlike, *e.g.*, *United States* v. *Sioux Nation of Indians*, *ante* at 234, 518 F. 2d 1298 (1975), it is not possible to point to any contemporary pronouncement, by Indians or whites, that the dealings with these funds essentially as bank checking accounts were unlawful or reflected a lack of fair and honorable dealings. The then state of the authorities makes it unlikely anyone would have so concluded had he studied the matter. The dissent does not construe the 1841 statute literally, any more than the majority does. If applicable, and taken literally, the statute would have impounded all IMPL funds for investment in United States "stocks", not just the excess over that needed for Indian support.

I simply cannot believe the Indian Claims Commission Act, 25 U.S.C. § 70, was written to fix on the United States a penalty liability of this speculative and dubious character.

DAVIS, *Judge*, dissenting in part:

The appeal is not from a simple accounting decision of the Indian Claims Commission, in which the disagreement of the parties revolves around technical accounting standards or factual differences. Rather, it is an appeal from grant of an accounting request in the most traditional sense—a claim that certain tribal rights (granted by statute) have been ignored by the United States, that discovery is required to determine the extent of the breach, and a demand that the defendant be held in damages for its actions. *See* 1 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE §§ 464–65 (1836).

At the heart of the matter, particularly for the period before 1918 (*see Cheyenne-Arapaho Tribes* v. *United States*, 206 Ct. Cl. 340, 512 F. 2d 1390 (1975))[1] is the proper interpretation of the Act of September 11,

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[1] In 1918, upon an appeal by the Secretary of the Interior that he be allowed to invest idle Indian funds in Liberty Bonds, to help both the Indians and the Treasury, Congress passed a law allowing the investment of "the trust funds of any tribe or individual Indian in United States Government bonds, * * *" Act of May 25, 1918, ch. 86, § 28, 40 Stat. 591; *see* 55 CONG. REC. 3438 (1917). Legislative history of this statute suggests strongly that IMPL funds were meant to be included in the monies which were available for such investment. *See ibid; Hearings on S. 8272 Before the Senate Comm. on Indian Affairs,* 64th Cong., 2d Sess. 46 (1917) (Testimony of Ass't Comm'r of Indian Affairs); COMBINED STATEMENT OF THE RECEIPTS AND DISBURSEMENTS, BALANCES, ETC. OF THE UNITED STATES DURING THE FISCAL YEAR ENDED JUNE 30, 1917 at 140–42 (1918). It appears that the statute went unused and the funds remained fallow in the Treasury. *See* S. REP. No. 1396, 70th Cong., 2d Sess. 1–2 (1929).

1841, ch. 25, 5 Stat. 465, *now codified at* 31 U.S.C. § 547a. I agree with the majority that without a statutory duty to make trust funds productive, coupled with a jurisdictional act (here the Indian Claims Commission Act, 25 U.S.C. §§ 70 et seq.) giving the appellants a forum in which to bring their action, the United States may incur trust duties which are unenforceable. *See United States* ex rel. *Angarica* v. *Bayard*, 4 Mackey 310, 327–28 (D.C. Sup. Ct. 1885), *aff'd*, 127 U.S. 251 (1888). However, to me the plain words of the 1841 statute required defendant to invest plaintiffs' "Indian Money, Proceeds of Labor" (IMPL) funds and the interest accruing, at a rate of not less than five percent per annum. Having failed to do so, the defendant must be held for damages.

The opinion of the Indian Claims Commission describes in great detail the history of the 1841 law, both prior and subsequent to its passage, and there is no reason to repeat the bulk of what is said there. *See Te-Moak Bands of Western Shoshone Indians* v. *United States*, 31 Ind. Cl. Comm. 427 (1973). The statute, as noted in the court's opinion, is extremely short and simple, and concerned largely with investments to be made with the money bequeathed to the United States by James Smithson. In section 1, the act repealed that part of an earlier statute which had provided that interest accruing on the funds would be invested in state "stocks,"[2] and provided that the interest would be invested "in any stock of the United States bearing a rate of interest of not less than five per centum per annum." Section 2 of the act then provided:

> That all other funds held in trust by the United States, and the annual interest accruing thereon, when not otherwise required by treaty, shall in like manner be invested in stocks of the United States, bearing a like rate of interest.

While the primary purpose of the legislation was undoubtedly to protect the Smithson bequest from disappearing as states defaulted on their bonds, the language of section 2 is broader in two respects. First, it applies to "all other funds held in trust," and second, it directs investment at a specified rate of return, not simply, as the Government contends, investment in United States securities. This point of a set rate of return was not slipped into the legislation unwittingly—the original House bill did not contain such a provision, which was added by the Senate Finance Committee. The "when not otherwise required by treaty" language was also added in the Senate, in response to the specific objections of Senator Sevier that the act conflicted with the provisions of earlier treaties. 10 CONG. GLOBE 422 (1841). This addition makes extremely questionable the Government's current contention that the 1841 statute is applicable only when a treaty or statute already required the investment of funds, since this was precisely the case excluded (to the extent of any inconsistency) from the statute on Senator Sevier's request.

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[2] During this period, "stock" included debt instruments.

As the opinion of the Indian Claims Commission shows, the history of administrative compliance with even the part of the 1841 act requiring that trust funds be invested in United States stocks was extremely spotty. There were almost as many times after 1841 when new or matured trust funds (from treaties not requiring investment in state stocks) were invested in state rather than United States securities as there were instances when such investment was refused because of the 1841 mandate. 31 Ind. Cl. Comm. at 474–77. An inconsistent administrative interpretation of a statute is entitled to little deference by this court, particularly where the statute itself is simple and straight-forward. *Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 745–46 (1973); *see United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 857, n. 24 (1975). The court stresses the failure of the authorities to apply the act to the IPML funds but that seems to me because the statute was neglected not that a conscious and reasoned decision was made that it failed to govern. The administrative practice is not helpful, one way or the other.

We do, however, have other sources to turn to for an indication of what the statute meant to those closer to its passage then we are. The major evidence of the legislative reading of the 1841 statute is in the debates surrounding passage of the Act of April 1, 1880, ch. 41, 21 Stat. 70, which authorized the payment of interest by the Treasury in lieu of investment for certain classes of Indian funds.[3] By 1880, a problem Senator Calhoun had foreseen in 1841 arose—there were no available United States securities which paid interest of 5% or more. The draft of the law which reached the Senate floor provided that in lieu of investment, the Secretary of Interior could deposit Indian funds in the Treasury at 4 percent interest. 10 Cong. Rec. 212 (1880). On the Senate floor, Senator Allison objected that such a statute would breach various treaties under which the United States had agreed to invest Indian funds at 5% *and also would be contrary to the obligation assumed in the 1841 act* which was held to be separate from and additional to obligations to invest found in various treaties. *Ibid.* at 213–15, 720. The bill was amended to delete the 4% interest provision and to provide that "the United States shall pay interest semiannually, from the date of deposit of any and all such sums in the United States Treasury, at the rate per annum stipulated by treaties *or prescribed by law*, . . ." Act of April 1, 1880, ch. 41, 21 Stat. 70 (emphasis added); *see* S. Rep. No. 186, 46th Cong., 2d Sess. 1–2 (1880). While this history is of course not definitive, I find that at least the Senate, only 39 years after 1841, thought that the earlier statute created an obligation to invest *all* Indian trust funds and the interest accruing thereon, whether required by treaty or not, in United States bonds not paying less than 5% interest.

Judicial construction of the 1841 statute has been almost as sparse as legislative interpretation, but what little there is supports this position. There are several cases in which the statute is merely mentioned in passing, probably because the parties in their briefs treated it as an alternative theory on a minor point. In *United States* v. *Blackfeather*, 155 U.S. 180 (1894), the Supreme Court refused to consider the Indians' claim for interest under the 1880 statute (which had been denied by the Court of Claims) because the Indians failed to cross-appeal. 155 U.S. at 186. However, the Court did cite the 1841 statute as that governing "the interest paid upon funds held in trust" without any limitation. *Ibid.* at

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[3] There is no question that the 1880 statute does not apply to IMPL funds which are not within the delimited categories of funds covered by that act.

192. In *United States* v. *Omaha Tribe of Indians*, 253 U.S. 275 (1920), the Indians made a general equitable claim for interest based largely on the grant of equity jurisdiction in the special jurisdictional act, mentioning the 1841 Act only once. Brief of the Omaha Tribe of Indians at 21–32. The Government brief entirely ignored the 1841 statute. Government Brief at 9–12. The Supreme Court denied the interest claim, not because the 1841 statute did not apply, but because no trust fund had ever been created. 253 U.S. at 282–83.

This same theory underlay the denial of interest in *Cherokee Nation* v. *United States*, 270 U.S. 476 (1926). This was an extremely complex case in which the Cherokees claimed about $2,000,000 in essentially compound interest on claims which had earlier been decided in their favor, with interest. *United States* v. *Cherokee Nation*, 202 U.S. 101 (1906). Again, the 1841 statute was discussed only briefly, with most of the parties' energies devoted to determining what the earlier decision had meant. In addition, the parties appear to have been talking past each other. The Indians claimed that the earlier decision retroactively returned funds to admittedly interest-bearing accounts as of March 4, 1895, and that the law of 1841 provided that the rate of return on those funds should be 5%. Reply Brief of Appellant at 9–11. The Government, on the other hand, contended that there had been no constructive return to interest-bearing accounts in 1895, and therefore that if interest were to be allowed on the claims, it should be from the time of the original treaty breaches (which had occurred as early as 1819), which would amount to an extremely large sum (contended to be "comparable in size to the national debt," but this was probably an exaggeration). Brief for the United States at 32–36.

The Supreme Court decided the issue on two grounds. First, it held that no funds had been held in trust for the Indians because the United States had *not*, either in 1819 or 1895, returned the moneys due the Indians to their trust funds in the Treasury. Second, the Court found that by an 1850 agreement, the Cherokees had agreed that interest on all debts owed them would be at 5% simple interest, and that more than this had already been paid. 270 U.S. at 492. The second theory is irrelevant to our case. However, the first theory is what distinguishes the claim of the Te-Moaks on cross-appeal from the major claim in this case. Like the Court I am of the view that where there are no funds held in trust for a tribe *even though money is due and owing under a treaty or because of defalcations*, the laws requiring either investment of trust funds or payment of interest on them are not applicable. This is so because in the absence of a trust fund, the Indians' only claim to monies due is as a debt, upon which no interest is available except where explicitly provided by statute, contract or treaty. *See Confederated Salish & Kootenai Tribes* v. *United States*, 175 Ct. Cl. 451, *cert. denied*, 385 U.S. 921 (1966) (Davis, J.)[4] An analysis of the two major Supreme Court cases holding that no interest would be allowed on a Court of Claims judgment shows that they turn on the theory that the amount due the plaintiff is due as debt, and not as beneficial owner of a trust fund such that the 1841 statute applies. *See United States* v. *Thayer-West Point Hotel Co.*, 329 U.S. 585, 588–89 (1947); *Goltra* v. *United States*, 312 U.S. 203, 211 (1941).[5]

The case in which there is the most complete discussion of the 1841 statute is *United States* ex rel *Angarica* v. *Bayard*, 127 U.S. 251 (1888), the facts of which are set out in the majority opinion. The Supreme Court never reached the issue of the applicability of the 1841 Act because it found that the money collected from the Spanish government, on which Angarica demanded interest, had been collected by the United States in its own right and not in trust for Angarica. 127 U.S. at 259. As in the *Omaha* case, *supra*, the necessary predicate for application of the 1841 law—a trust fund—was missing.

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[4] For this same reason, I disagree with the Commission's damages accounting to the extent that it "returns" disallowed disbursements to the IMPL fund before calculating damages. *Te-Moak Bands of Western Shoshone Indians* v. *United States*, 33 Ind. Cl. Comm. 417, 428 (1974).

[5] *United States* v. *N.Y. Rayon Importing Co.*, 329 U.S. 654 (1947), did involve a trust fund. However, neither the parties nor the Court discussed the 1841 Act—the entire claim was based on equitable grounds that interest was "right and just." *Ibid.* at 659. The trust fund there involved, moreover, was rather unusual in that it was, by the terms of the statute under which it was created, to be dissolved at the end of two years and the money to return to the United States, not the beneficial owner. Act of June 26, 1934, ch. 756, § 21, 48 Stat. 1235.

The District of Columbia Supreme Court (where the case had been brought originally) did, however, comment extensively on the 1841 statute although it too found the law inapplicable. *United States* ex rel. *Angarica* v. *Bayard*, *supra*, 4 Mackey at 322. The court found that the 1841 statute applied only to trusts which had three characteristics missing in Angarica's case:

> (1) That the funds were deposited in the Treasury rather than retained by a department.
> (2) That the funds were to be invested by the Secretary of the Treasury rather than by the head of any other department, and
> (3) That the funds could not be disbursed without congressional authorization. *Ibid.* at 324.

All these characteristics are present in the case of the IMPL funds.

When Congress, by a rider to the Deficiency Appropriations Act of 1883, ch. 141, 22 Stat. 590, required that miscellaneous revenues from Indian reservations be "covered into the Treasury for the benefit of such tribe * * *," the Secretary of the Interior and the Commissioner of Indian Affairs intended to treat the fund as the Secretary of State had treated Angarica's money—as essentially a checking account, totally under the control of the Secretary of Interior. *See* Letter from the Secretary of the Interior to the Commissioner of Indian Affairs, dated April 19, 1883; Letter from Commissioner of Indian Affairs to the Secretary of the Interior, dated November 14, 1883. The Acting Secretary of the Treasury, however, determined that the act created a fund with the characteristics described in *Angarica.* The money was to be taken out of direct control of the department and deposited in the Treasury (this was agreed by all as the purpose of the act); investments were to be handled by the Secretary of the Treasury (under the Act of June 10, 1876, ch. 122, 19 Stat. 58, *now codified at* 25 U.S.C. § 160); and, most tellingly, the funds could not be touched by the Department of the Interior or the Indians until Congress specifically authorized such actions (*see* Letter from Acting Secretary of the Treasury to the Secretary of the Interior, dated November 26, 1883). In 1887 Congress, at the urging of the Secretary of the Interior, did make the authorization demanded by the Treasury Department, but in doing so emphasized the trust nature of the funds by declaring that the money must be used for the benefit of the tribes which had produced the revenue. Act of March 2, 1887, ch. 320, 24 Stat. 463.

This court has considered the scope of the 1841 Act twice, both times very briefly, and has reached contrary conclusions about the act's applicability to non-treaty trust funds.[6] In *Bonnar* v. *United States*, 194 Ct. Cl. 103, 438 F. 2d 540 (1971), as the majority opinion notes, we rejected the act's application to funds held under the Trading with the Enemy Act, 50 U.S.C. App. § 9(a) (1970), on two grounds, the most important of which, we said, was that the Act, by its own terms, explicitly limited recovery to the net proceeds of sale. 194 Ct. Cl. at 163–64. We also stated that the Trading with the Enemy Act should have referenced the 1841 Act if that statute was meant to apply. *Ibid.* at 163. It is a maxim of construction that general statutes apply to later specific acts unless the later act is clearly inconsistent with the former. *See Regional Rail Reorganization Act Cases*, 419 U.S. 102, 133–34 (1974). It may well be that section 7(c) of the Trading with the Enemy Act, which limits recovery to net proceeds, *is* inconsistent with the 1841 law and that therefore the earlier statute did not apply. However, we do not have such a case here, and the failure of the 1883 statute to make reference to the 1841 act should not bar the application of the first-passed statute.

The second case in which we have considered the 1841 Act is more on point. In *Confederated Salish & Kootenai Tribes* v. *United States*, we were asked, among other things, to decide whether interest on plaintiff's trust fund "Proceeds of Flathead Reservation, Montana" should be granted pursuant to the 1880 Statute, 25 U.S.C. § 161. It will be remembered that that statute provides that certain funds might be kept in the Treasury in lieu of investment, with interest paid "at the rate per annum stipulated by treaties or prescribed by law." No treaty or particular act of Congress required that the proceeds of the Flathead Reservation be invested or that interest be paid, although the Act of April 23, 1904, ch. 1495, § 14, 33 Stat. 305, did provide that the funds received were to be paid into the Treasury and expended "for the benefit of said Indians." The plaintiffs argued that their funds were clearly proceeds of "Indian trust lands" and therefore entitled to interest under the 1880 statute, at the rate of 5% *as provided by the law of 1841*. Motion for Instructions to the Commissioner, etc. at 1 (filed Aug. 15, 1968). The government responded that the 1841 statute was inapplicable in construing the 1880 law. Response to Motion for Instructions, etc. at 8–9 (filed Oct. 23, 1968). This court found for the plaintiff, and in doing so necessarily concluded, contrary to defendant's present assertions, that the 1841 law in applicable to funds for which no special investment provision in a law or treaty exists. Order, *Confederated Salish & Kootenai Tribes* v. *United States* (Dec. 9, 1968), *reported at* 186 Ct. Cl. 947.

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[6] In *Creek Nation* v. *United States*, 78 Ct. Cl. 474 (1933), which the majority cites for the proposition that no interest is payable on IMPL funds, Majority Op. *ante* at 399–400, the Creeks argued strongly that their money should never have been put in an IMPL fund, since the Five Civilized Tribes were excluded from the 1883 Act, and never requested interest on such a fund. Plaintiff's Request for Findings of Fact and Brief at 49–51. This is another case, furthermore, in which neither party ever mentioned the 1841 Act.

That the IMPL fund created by these statutes is a trust fund is conceded by the government. Brief of United States at 47;[7] *see Cheyenne-Arapaho Tribes* v. *United States*, *supra*, 206 Ct. Cl. at 345, 512 F. 2d at 1392. The infirmity which prevented recovery by the Omahas and Angarica, *supra*, is therefore not present here. Rather, the government relies on two other propositions to deny application to the plain letter of the 1841 statute. First, the point is made the act applies only to "trusts of a definite character," upon which a treaty or another act of Congress provided that interest should be paid or the fund invested. There are three answers to this. First, the "trusts of a definite character" language comes from the District of Columbia Supreme Court decision in *Angarica*. As we have shown, the IMPL fund falls within the class as to which that court found the 1841 Act to apply. Second, we have already rejected the argument that another treaty or act is required as a predicate for application of the 1841 Act in the *Confederated Salish* case, and that decision should govern here. Third, the terms of the statute are not so restricted and there is insufficient reason in its history to read it so narrowly.

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[7] In 1934, Congress specifically declared the IMPL fund to be a "trust fund." Act of June 26, 1934, ch. 756, § 20(20), 48 Stat. 1233, *now codified at* 31 U.S.C. § 725s (20) (1970). While this action came after the statute providing that interest be paid on such funds, Act of June 13, 1930, ch. 483, § 2, 46 Stat. 584, neither that statute nor any other after 1887 altered the terms of the original statute which had provided that the funds were to be held "for the benefit" of the Indians. This later Congressional action, therefore, may be seen as a ratification of its earlier intent to treat IMPL funds as a trust fund.

The defendant's second ground for rejecting application of the 1841 Act is simply that it would cost too much now to penalize the government for failure to comply with the statute from 1883 to 1930.[8] Damages for failure to comply from 1883 to 1930 are the lost profits which would have resulted from the investments. Since the 1841 Act provides a *minimum* return on investment of 5% compounded, and the Indians have not cross-appealed on the Commission's failure to use a higher rate, I agree with the Commission that damages should be figured at 5% interest compounded annually, on the *actual* annual surplus in the IMPL fund. (See note 4, *supra.*) My own, admittedly rough, calculations lead me to believe that the damages payable to all Indian tribes for lost profits on the IMPL account from 1883 to 1930 will not exceed $15,000,000.[9] Even if I am mistaken in that, I remain convinced that the law is as I have previously stated in response to a similar governmental claim:

> It is irrelevant that an award of interest, pursuant to the [1841 statute], could increase the award to plaintiff by five or six times. If the [statute] so provides, we cannot refuse interest because the amount is relatively large. *Peoria Tribe* v. *United States*, 177 Ct. Cl. 762, 770, 775 n. 6 (1966) (Davis, J., dissenting), *rev'd*, 390 U.S. 468 (1968).

The 1841 statute provides the Indians with a right to recover within the jurisdiction created by paragraph (1) of the Indian Claims Commission Act—"claims in law or equity arising under the Constitution, laws, treaties of the United

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[8] Since no claim is made for damages after 1930, I leave to another day the issue whether the Act of June 13, 1930, ch. 483, § 2, 46 Stat. 584, providing simple interest at 4% on IMPL funds held in the Treasury, superseded the 1841 statute.

[9] As stated above, *supra*, note 4, these damages are calculated on the basis of actual surplus funds in the Treasury, and do not include damages on illegal disbursements.

States, and Executive orders of the President," 25 U.S.C. § 70a(1) (1970). This language tracks that of the early special jurisdictional statutes, and as such does not create any equitable right to enforce general trust duties undertaken by the United States where, for some reason, the 1841 statute is inapplicable. *See United States* v. *Omaha Tribe of Indians*, *supra*, 253 U.S. at 283.

However, in establishing the Indian Claims Commission Congress did not, as we have noted many times before, merely consolidate all the old special jurisdictional acts. It went further, providing a new cause of action for "claims based upon fair and honorable dealings that are not recognized by any existing rule of law or equity." 25 U.S.C. § 70a(5). *See Otoe and Missouria Tribe of Indians* v. *United States*, 131 Ct. Cl. 593, 602, 131 F. Supp. 265, 271, *cert. denied*, 350 U.S. 848 (1955). This does not mean that the United States has agreed to pay the Indians for all pre-1946 wrongs. *Gila River Pima-Maricopa Indian Community* v. *United States*, 190 Ct. Cl. 790, 797, 427 F. 2d 1194, 1197–98, *cert. denied*, 400 U.S. 819 (1970). We have, however, determined that such a clause does extend government liability when three conditions are met; first, that there be an express undertaking by the United States, by treaty, agreement, executive order, or statute, of a duty of trustee toward the Indians; second, that the United States has failed to meet its obligations; and third that the tribe has suffered damages as a result. *Aleut Community of St. Paul Island* v. *United States*, 202 Ct. Cl. 182, 196, 480 F. 2d 831, 838–39 (1973). These three conditions are met here, and should result in recovery by the Indians of profits lost by breach of fiduciary duty by the United States, although the measure of damages under traditional trust law, lost profits at simple interest, differs from that mandated by the 1841 Act. *See Ute Tribe of Indians* v. *United States*, 45 Ct. Cl. 440, 470 (1910).

In 1883, by statute, Congress declared that money admittedly belonging to the Indians would, instead of being given to the Indians, be "covered into the Treasury for the benefit of such tribe." Act of March 3, 1883, ch. 141, 22 Stat. 590. In 1887, the Secretary of the Interior was, again by statute, explicitly given the power to use these funds, but only for the benefit of the tribes on whose account the funds had originally been added to the fund. Act of March 2, 1887, ch. 320, 24 Stat. 463. These two statutes, in the most traditional sense, created a trust for the benefit of the Indians, a fact belatedly recognized by the Treasury in 1908. 2 J. Story, Commentaries on Equity Jurisprudence § 980 (1836); *see* Restatement of Trusts 2d, § 24, comm. b, illus. 1 (1959); *Te-Moak Bands of Western Shoshone Indians* v. *United States*, *supra*, 31 Ind. Cl. Comm. at 506–508.

Under standard trust law, which has remained largely constant through the last century, a trustee's duties include (unless explicitly negated by the terms of the trust, not a problem here) the obligation to make trust funds productive by investing whatever money is not required by the terms of the trust to be distributed. *See* Restatement of Trusts 2d, Introductory Note at 1, § 181 (1959). From 1883 to 1887, the terms of the statute permitted no disbursal at all, so the duty arose to make the entire amount in the fund productive. The 1887 Act amended the terms of the trust to allow the Secretary of the Interior to spend the funds in the IMPL fund for the benefit of the tribe on whose account the money was covered into the Treasury. From 1887 on, then, the duty to make funds productive was limited to surpluses remaining in the account, after charges, which would not be needed in the reasonably foreseeable future. When the annual surplus in the total IMPL fund for all Indians which, according to Treasury Department reports, fell below $1,000,000 for only one year (fiscal 1925) between 1902 and 1930 and reached to over $9,000,000 in fiscal 1923,[10] was left to lie fallow earning

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[10] *See* Statement of Balances, Appropriations, and Expenditures of the Government for the Fiscal Year Ended June 30, 1902 at 98–99 (no date); *Ibid.* for the Fiscal Year Ended June 30, 1903 at 116–17 (no date); *Ibid.* for the Fiscal Year Ended June 30, 1904 at 114–15 (no date); *Ibid.* for the Fiscal Year Ended June 30, 1905 at 118–19 (no date); *Ibid.* for the Fiscal Year Ended June 30, 1906 at 108–09 (1907); *Ibid.* for the Fiscal Year Ended June 30, 1907 at 144–45 (1908); Statement of Balances, Appropriations, and Disbursements of the Government for the Fiscal Year Ended June 30, 1908 at 124–25 (1908); *Ibid.* for the Fiscal Year Ended June 30, 1909 at 138–39 (1909); *Ibid.* for the Fiscal Year Ended June 30, 1910 at 128–29 (1911); *Ibid.* for the Fiscal Year Ended June 30, 1911 at 146–47 (1912); Combined Statement of the Receipts and Disbursements, Balances, etc., of the United States for the Fiscal Year Ended June 30, 1912 at 105

(Continued)

absolutely no interest, the tribes to whom portions of the fund belonged suffered sufficient damage to allow recovery under the fair and honorable dealings clause for the breach of trust. This is wholly apart from the 1841 Act and furnishes an alternative and supplementary ground for recovery by the appellees.

518 F. 2d 1210

## BANKERS TRUST COMPANY, FRANCIS D. BUTLER, GILBERT M. HAAS, EARL KNUDSEN, AND NORMAN F. SPRAGUE, JR., TRUSTEES UNDER AGREEMENT OF TRUST DATED JULY 18, 1961, TRANSFEREES OF THE ASSETS OF MESABI IRON COMPANY, DISSOLVED v. THE UNITED STATES

[No. 89-67. Decided July 11, 1975. Plaintiffs' motion for rehearing denied October 3, 1975. On December 29, 1975 plaintiffs filed a petition for certiorari.]

ON THE PROOFS

**Taxes; income tax; corporate stock received in settlement of claims; valuation date and valuation; "blockage" factor.**—This is a suit for refund of income tax for 1960 and assessed interest, plus statutory interest. In 1939 Mesabi Iron Company was in debt with few liquid assets, and to pay its debts, but at the same time to retain the possibility of future profits from mining operations, Mesabi agreed with Reserve Mining Company to lease to Reserve the lands which Mesabi owned and to assign to that company two leasehold interests; in return Reserve took over Mesabi's debts and agreed, *inter alia*, to pay Mesabi one-third of the net profits obtained from mining

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(Continued)
(1912); *Ibid.* for the Fiscal Year Ended June 30, 1913 at 121 (1913); *Ibid.* for the Fiscal Year Ended June 30, 1914 at 124 (1914); *Ibid.* for the Fiscal Year Ended June 30, 1915 at 142 (1915); *Ibid.* for the Fiscal Year Ended June 30, 1916 at 128 (1916); *Ibid.* for the Fiscal Year Ended June 30, 1917 at 142 (1918); *Ibid.* for the Fiscal Year Ended June 30, 1918 at 142 (1919); *Ibid.* for the Fiscal Year Ended June 30, 1919 at 154 (1920); *Ibid.* for the Fiscal Year Ended June 30, 1920 at 162 (1921); *Ibid.* for the Fiscal Year Ended June 30, 1921 at 173 (1921); *Ibid.* for the Fiscal Year Ended June 30, 1922 at 176 (1923); *Ibid.* for the Fiscal Year Ended June 30, 1923 at 101 (1924); *Ibid.* for the Fiscal Year Ended June 30, 1924 at 103 (1925); *Ibid.* for the Fiscal Year Ended June 30, 1925 at 107 (1926); *Ibid.* for the Fiscal Year Ended June 30, 1926 at 106 (1927); *Ibid.* for the Fiscal Year Ended June 30, 1927 at 157 (1928); *Ibid.* for the Fiscal Year Ended June 30, 1928 at 157 (1929); *Ibid.* for the Fiscal Year Ended June 30, 1929 at 155 (1930); *Ibid.* for the Fiscal Year Ended June 30, 1930 at 332 (1931).

operations on the lands. Controversies between the two arose, culminating in litigation concerning royalties, antitrust charges, etc. In February 1960 the parties reached an agreement settling their differences, subject to shareholder approval, under which Mesabi would receive a sum of money and all of Reserve's stock in Mesabi, and Mesabi would drop all claims against Reserve and others, and the 1939 agreement would be modified to provide Mesabi with stated royalties. On April 22, 1960 the agreement was approved by the shareholders. Between February 18 and April 22 the price of Mesabi stock on the American Stock Exchange rose from $40⅝ to $78¼. The controversy in this court centers on whether the value of the stock for income tax purposes was its worth as of February 18 or April 22, 1960; if the April 22 date is appropriate, the value of the stock on that date. It is *held* that the stock received by Mesabi must be valued as of April 22 since the settlement was not considered permanent and effective until the stockholders approved, which throughout the negotiations was treated as a significant condition precedent. It is also *held*, for the reasons given, that the value of the stock Mesabi received was, on April 22, 1960, the mean of the high and low prices at which the stock was sold on the exchange on that day, $78.25, and that Mesabi has not shown itself entitled to any "blockage" discount. Taxpayer is not entitled to recover and the petition is dismissed.

**Taxes; income tax; accounting period and method of accounting; taxable year for which items of gross income included; generally.**

[1] Under the Federal income tax system, items are taken into income at their then current value. When income is received, be it on the day the right to receive becomes fixed, as with an accrual basis taxpayer, or when beneficial ownership commences for a cash basis taxpayer, the amount of income received becomes set at its then value. The same principle applies to an exchange of property.

**Internal Revenue 🔑 1290**

**Taxes; income tax; gain or loss on disposition of property; valuation of corporate stock; valuation date.**

[2] Where corporation M under the terms of an agreement was to receive certain shares of its own capital stock in payment for settlement of claims for royalties on land leased to corporation R and settlement of other related litigation, in view of the record evidence that no effort was made to close the transaction before the vote of M's shareholders, that the shareholders' approval was treated throughout as a most significant condition precedent, and that such approval, though probable, was not a mere formality, the value of the stock for Federal income tax purposes was its worth on the date M's shareholders gave their approval of the agreement rather than the date on which the negotiators reached agreement.

**Internal Revenue 🔑 1291**

**Taxes; assessment of tax; valuation of transferred property by agreement of parties; acceptance of by Internal Revenue Service.**

[3] While the parties may be normally bound by the value of transferred property agreed upon between them, the Internal Revenue Service is not so restricted for purposes of income tax assessment.

Internal Revenue ⊂⊃ 1290

**Taxes; income tax; gain or loss on disposition of property; fair market value.**

[4] The fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts.

Internal Revenue ⊂⊃ 1290

**Taxes; income tax; gain or loss on disposition of property; fair market value; corporate stock.**

[5] Where stock is freely traded in an open, organized market, stock exchange quotations for the valuation date of the shares actually being valued generally provide the best evidence of value.

Internal Revenue ⊂⊃ 1291

**Taxes; income tax; gain or loss on disposition of property; fair market value; corporate stock.**

[6] Extraordinary circumstances relating either to the state of the stock market or to the shares actually being valued can make market quotations unreliable indicators of true value; for instance, restricted stock, being less marketable (for instance, under a sequestration order or restriction as to resale), may have a lower value than that traded on the stock exchange, or a large number of shares may involve a "blockage" factor.

Internal Revenue ⊂⊃ 1291

**Taxes; income tax; gain or loss on disposition of property; valuation of corporate stock; stock market quotation v. "barter-equation method".**

[7] The "barter-equation method" of valuing shares of stock is a method which should be used only under certain limited conditions.

Internal Revenue ⊂⊃ 1291

**Taxes; income tax; gain or loss on disposition of property; valuation of corporate stock; "blockage" factor.**

[8] In deciding whether the blockage factor requires discounting or discarding stock market prices in determining the fair market value of transferred corporate stock, the problem should be treated in terms of whether the market could have absorbed the shares within a reasonable period of time. Where the number of shares to be valued is smaller than that traded during a single month, absent evidence to the contrary, the shares could have been absorbed fast enough for a blockage discount to be inapplicable.

Internal Revenue ⊂⊃ 1291

*David W. Richmond*, attorney of record for plaintiff. *Robert L. Moore, II* and *Miller & Chevalier*, of counsel.

*Milan D. Karlan*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser* and *Donald H. Olson*, of counsel.

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

This action to recover corporate income taxes assessed and paid was brought on behalf of the Mesabi Trust by its trustees, as successor to the Mesabi Iron Company. The taxes were assessed as a deficiency in the Mesabi Company's 1960 return, and all relevant events occurred prior to the July 18, 1961 change to trust status. The company rather than the trust and trustees will be referred to as "Mesabi," "the taxpayer," and "plaintiff."

The disputed tax, amounting to $3,016,132.64 plus interest, arises from a difference between plaintiff and the Internal Revenue Service as to the value of 163,570 shares of Mesabi stock received by the company during 1960 from the Reserve Mining Company. The parties' earlier motions for summary judgment were denied without prejudice and the case remanded for full development of the facts. 198 Ct. Cl. 306, 459 F. 2d 484 (1972). A trial was held before Trial Judge Lloyd Fletcher who decided in favor of the Government. We now confirm that conclusion.

## I

### *Facts*

The events leading to the ultimate transfer of the stock, which are rather complex, are fully set out in the findings of fact made by Trial Judge Fletcher and which we adopt with minor modifications. Here we summarize only the most important steps. Mesabi Iron Company was incorporated in 1919 to mine iron ore in the Mesabi Iron Range in northern Minnesota. In consideration for the issuance of its stock, the company acquired fee ownership of a 5,700 acre tract and a leasehold interest in two other areas, one of 720 acres (Cloquet lease), and the other of 9,000 acres (Peters lease).

Although Mesabi attempted to mine the leaseholds, the iron was a low grade ore called taconite and needed concentration in order to become commercially useful. Mesabi was unable to concentrate the ore on a profitable basis and suspended all mining operations in 1924.

By 1939, Mesabi was in debt by approximately $258,000 with few liquid assets. To pay its debts, but at the same time to retain the possibility of future profits from mining operations, Mesabi agreed with Reserve Mining Company, a newly formed corporation the stockholders of which were four iron and steel corporations, to lease to Reserve the lands which Mesabi owned and to assign to that firm the two leasehold interests. In return, Reserve took over Mesabi's debts and agreed, among other things, to pay Mesabi one-third of the net profits obtained from the lands, and to "endeavor to procure the highest current price known for material of like value in use and for like quantities" in making sales and determining profits. The parties set up a two-man board of arbitration to settle disputes, with a third arbitrator to be appointed if the first two disagreed.

Between 1942 and 1944, Reserve purchased through negotiation and on the open market, but with the help of Raymond B. Hindle, a stock broker who was also a director of Mesabi, 148,700 shares of Mesabi stock, or approximately 12% of the outstanding total. Starting in 1951, Reserve began to develop its Mesabi leaseholds, having devised a commercially feasible way of concentrating the taconite. This development required capital expenditures of approximately $178 million which was financed in part by Reserve's stockholders and in part by borrowing. By 1956, Reserve began producing taconite pellets, an extremely useful form of iron ore, the entire production of which was sold under a 1953 agreement to the two companies which by then had sole and equal interests in Reserve—Republic Steel Corporation and Armco Steel Corporation.

From 1953 on, Reserve issued annual reports to Mesabi in which the former stated its net profits for the year and calculated Mesabi's share. Mesabi refused to accept each of these reports, contending that the sale price of the taconite was too low in that it did not take into account the efficiencies obtained by using the uniform, concentrated pellet, that some charges by Reserve for such items as hauling the taconite on Reserve's private railroad from the mine near Babbit to the production facilities at Silver Bay were too high, and that various other charges, such as losses on in-town real estate sales in Silver Bay, should not have been assessed at all. In addition, Reserve wished to offset immediately Mesabi's part of pre-production losses against Mesabi's profit share, while Mesabi wanted to amortize these losses over a number of years.

The preproduction loss issue was settled in 1956 with an agreement to amortize the pre-1956 losses over a 13-year period, one-third falling on Mesabi and two-thirds on Reserve. The other questions were still outstanding before either a two- or a three-man board of arbitration in February 1960.

During the late 1950's, the differences between Mesabi and Reserve came to a head in litigation. In 1957, several Mesabi shareholders filed a derivative action against Reserve and the then Mesabi board of directors, complaining about the failure of Mesabi to effectively prosecute its claims against Reserve. The complaint stated that Reserve was indebted to Mesabi for 1956 profits in the amount of $8,000,000. The Delaware court in which the suit was brought sequestered Reserve's stock holdings in Mesabi. In 1958, a dissident group of stockholders won a proxy fight against the old Mesabi management (Reserve voting its shares for the losing side). New management informed Mesabi shareholders that the arbitration would not lead to an acceptable agreement with Reserve in a reasonable period of time, and that Mesabi would now attempt to settle the differences in court. Reserve then filed an action in a Minnesota state court (removed at Mesabi's request to federal district court) to force Mesabi to live up to its agreement to arbitrate. Mesabi countered with counterclaims against Reserve and its stockholders, Armco and Republic, for antitrust violations in the distribution and pricing of taconite and for conspiring to interfere with the lease agreements. Mesabi also brought an antitrust action on a similar basis against Armco and Republic in the federal district court in Delaware and another suit in a Delaware state court against Reserve and Raymond Hindle, alleging a diversion of corporate opportunity in Reserve's 1940's purchases of Mesabi stock and requesting return of the stock. The new management also took over the position of the plaintiff stockholders in the Delaware derivative action. None of these cases was settled or completed prior to February 1960.

The alleged dollar values of the suits, according to the complaints, were:

(1) $8,000,000 lost profits for 1956 in the derivative suit
(2) $16,166,667 lost profits for 1956 and 1957 in the Minnesota counterclaim
(3) $12,500,000 trebled ($37,500,000) for antitrust violations in the Minnesota counterclaim
(4) $22,500,000 trebled ($67,500,000) for antitrust violations in the Delaware federal suit

In addition, the Delaware state suit requested the return of 148,700 shares of Mesabi stock,[1] and Mesabi continued to pursue lost profit claims for 1958 and 1959 out of court. While the amounts listed above obviously overlap in some respects and are undoubtedly exaggerated, they do provide some idea of the magnitude of the claims Mesabi had outstanding against Reserve and its shareholders as of February 1960.[2]

By January 1960, the three-man board of arbitration had completed hearings on all questions except that of the propriety of Reserve's pricing of taconite pellets in its sales to its owners, Armco and Republic. On January 21, 1960, the independent arbitrator ruled that Reserve should turn over to Mesabi its records dealing with the price of taconite pellets in sales to Republic and Armco. The hearings were adjourned until March 1960.

Possibly because of this new development, the arbitration proceedings were never reconvened. Rather, Reserve initiated talks aimed at settlement of all disputes. Reserve's goal seems to have been to end all past, present, and future controversies over net profits by putting Mesabi's payments on a royalty-per-ton basis, a proposal Reserve had made several times since 1950. Mesabi was similarly anxious to get out of litigation on net profits, but only at a royalty substantially higher than that offered previously. Mesabi management was also very interested in acquiring Reserve's 12% of the outstanding Mesabi stock, in order to eliminate the threat that Reserve would vote its stock in its own interest rather than Mesabi's.

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[1] The number of shares held by Reserve was increased to 163,570 as a result of a 1959 "stock dividend." It was later discovered that Mesabi did not have sufficient surplus to issue a legal dividend, and the transaction was relabeled a "stock split" and so entered on Mesabi's books.

[2] Not included in the listing is the almost $10,000,000 lost-profits claim for the years 1956–1958 which Mesabi was pursuing in arbitration. *See* Finding of Fact 29.

On February 18, 1960, the negotiators reached an agreement under which Mesabi would receive $400,000 and all of Reserve's stock in Mesabi (now 163,570 shares, *see* footnote 1, *supra*). Mesabi would drop all claims against Reserve, its shareholders, and Hindle, and the 1939 agreement would be modified to provide Mesabi with royalties of $1.00 per adjusted ton of taconite concentrate shipped. At Reserve's request, the agreement provided that it would not become effective until approved by a majority of Mesabi's outstanding shares but that the shares held by Reserve could not be voted nor counted toward the majority. The closing was to take place on the fifth business day following approval by Mesabi's shareholders.

On February 19, 1960, Reserve's directors and its two shareholders approved the agreement. Mesabi's directors met the same day and passed a series of approving resolutions. The only significant difference between the agreement and the resolutions was that while the former indicated that the stock and cash would both be exchanged for the pre-1960 profits claims and those claims only (not for the antitrust claims), the resolutions provided that the cash would be tied to the claims relating to pre-production losses, the profits claim, and the lease modification, that all suits against Reserve would be dismissed by Mesabi with prejudice, and that Mesabi would receive Reserve's shares. The minutes of that meeting, and testimony taken at trial, indicate that Mesabi's directors were concerned whether the agreement was a fair exchange and also about its tax consequences, and the company's counsel, Mr. Lester Tanner, advised them on these matters.

While the minutes do not so show, Mr. Tanner testified that he had advised the board that the stock and cash together, using the closing price of the stock on the American Stock Exchange on February 18,—40⅜, were worth approximately $7,000,000 and that this amount was about all Mesabi could expect to obtain from its pending claims. Mr. Tanner also advised, according to this trial testimony, that Mesabi's tax liability from the settlement would be a maximum of $7,000,000 of ordinary income, but that it was possible that the exchange could be viewed as a tax-free redemption or an exchange of capital assets.[3]

On February 20, Mesabi issued a press release and shareholders' letter stating that a settlement had been reached, subject to shareholder approval, and briefly outlining the details of the agreement. The release and letter, although not the agreement itself, also stated that the shares received would not be reissued. The formal settlement agreement, which tracked the draft agreement rather than the resolutions and was dated February 19, 1960, was signed by Mesabi's president on February 28, and by Reserve's on March 2. Between February 18 and March 2, the closing price of Mesabi stock on the American Stock Exchange rose from 40⅜ to 60⅞. On March 21, 1960, Mesabi sent its stockholders a proxy statement (dated March 18) for the April 22 shareholders' meeting at which there would be a vote on the settlement agreement. The proxy statement did not attempt to put any value on the shares to be received from Reserve. It also did not indicate that the stock was to be received only in exchange for the royalty claims. On March 22 and 23, it was reported in the press that Mesabi was considering changing from corporate to trust form to avoid double taxation of its profits if the settlement agreement were approved. On April 7, Reserve announced its intention to expand production, which would, of course, increase Mesabi's royalties.

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[3] While Mr. Tanner likewise testified that Mesabi was deeply concerned about the extent of its tax liability and would not have wanted a more lucrative settlement because the company was cash-poor, we hesitate to accept this observation since this concern is nowhere noted in the minutes of the meeting, and Mesabi paid its shareholders a cash dividend of $3.00 per share, or a total of $3,579,672, in November 1960—after the settlement and before the 1960 taxes were due. The dividend was, in fact, paid over the objection of plaintiff Haas that the cash would be needed for tax purposes. Furthermore, Mesabi floated an issue of 119,322 shares of stock at $60.00 a share in early 1961, which it evidently had no difficulty selling to its shareholders through a rights offering (the stock was priced on the market at approximately $120 when the rights were issued). The prospectus for the rights offering stated that the shares were being sold to create a cash reserve to pay taxes which might be due because of the settlement if the Mesabi shares received were valued at a price higher than 40⅜.

During this entire period, various brokerage houses were advising customers to buy Mesabi stock as a good income investment and also for possible capital gain. Presumably because of the settlement and related activities, trading in Mesabi stock increased substantially in volume from February 18 on. For example, 24,600 shares were traded in January, 145,100 in February, and 172,700 in March. In addition, the price began a lengthy and substantial climb from 40⅜ on February 18, 1960 to over 90 by the end of 1960. On April 21, the day before the Mesabi shareholders' meeting, the stock closed at 82¾, and the mean sales price on April 22 was 78¼.

At the April 22 shareholders' meeting, the agreement was approved by a vote of 1,016,049 shares to 970 shares, far in excess of the 661,898 shares needed to ratify. Approximately 87% of the shares eligible to vote were voted. By April 27, when the closing took place, all of Mesabi's litigation with Reserve, Republic and Armco had been terminated. Mesabi received Reserve's shares, the $400,000 provided by the settlement agreement, and $1,464,960.05 as a royalty payment for the first quarter of 1960. The shares were received free and clear of all claims, liens, or encumbrances, since the sequestration orders covering them had been lifted at Mesabi's request on April 25. The mean price for which Mesabi stock was selling on the American Stock Exchange on April 27 was 73¼.

In its 1960 income tax return, plaintiff acknowledged that it had received income through the settlement agreement, declaring the shares to have been worth $5,908,966.25—163,570 shares at $40.375 each (the February 18, 1960 closing price on the American Stock Exchange) less a "blockage" discount of $4.25 per share. The Internal Revenue Service, on the other hand, took the position that the proper value of the stock was its value on April 22, 1960 (when the shareholders approved the settlement agreement), that that value is best evidenced by the mean trading price on the American Stock Exchange that day, *i.e.*, $78.25, and that plaintiff had not shown itself entitled to any blockage discount. Defendant therefore priced the stock at $12,799,352.50. The disputed tax is a result of this difference in valuation, with credits for increased state royalty taxes and for increased depletion deductions if the higher figure is taken into account.

The controversy in this court centers on whether (1) the value of the stock for tax purposes was its worth as of February 18, 1960, the date on which negotiators for Mesabi and Reserve reached their agreement, or April 22, 1960, the day on which the Mesabi shareholders gave their approval; and (2) if the April 22 date is chosen, the value of the stock on that date. Plaintiff contends that the value as of February 18, 1960 is the proper figure but that even if April 22 is the crucial date, the correct April 22 value of the block of shares was no more than its February 18 value.[4]

## II

### *Valuation Date*

Plaintiff insists that this is not an "accounting" case, since there is no issue as to *when* the value of the shares was to be taken into income; Mesabi was on the accrual basis and taxpayer agrees that the taking-into-income date was April 22, 1960, when the Mesabi-Reserve agreement became final and binding through the vote of Mesabi's stockholders. But, says plaintiff, the valuation date need not be the same as the taking-into-income date; in this instance it should be February 18, 1960, when the parties made their bargain and (it is said) fixed a firm value for the shares to be transferred.

Our difficulty with this approach is that it runs counter to the basic principle that under the federal income tax system items are taken into income at their then current value. The Code's provision for different accounting methods, and related regulations, do not directly tell us this but they do so by implication, and this has been the consistent course of judicial and administrative treatment under the income tax. *See* Treas. Reg. §§ 1.61-2(d)(4), 1.451-1(a), 1.61-2(d)(2)

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[4] Plaintiff's petition originally claimed in the alternative that the shares were received in a tax-free redemption or in exchange for a capital asset. Both theories have been discarded by stipulation and are not before us.

(i). It is this proposition which, for example, creates the need to undertake the difficult task of determining the present value of future interests. *See* Treas. Reg. § 1.1001-1(a); Rev. Rul. 58-402, 1958-2 C.B. 15; *Grill* v. *United States*, 157 Ct. Cl. 804, 809-11, 303 F. 2d 922, 925-26 (1962). *Compare Burnet* v. *Logan*, 283 U.S. 404 (1931) (rights to future receipts presently incapable of valuation need not be included in income until received). When income is received, be it on the day the right to receive becomes fixed, as with an accrual basis taxpayer, or when beneficial ownership commences for a cash basis taxpayer, the amount of income received becomes set at its then value. *See Fordyce* v. *Helvering*, 76 F. 2d 431, 434-35 (C.A.D.C. 1935); *C. M. Hall Lamp Co.* v. *United States*, 201 F. 2d 465, 468 (C.A. 6, 1953); *Hoffer* v. *Comm'r*, 24 B.T.A. 22, 27 (1931). Parties cannot arbitrarily decide that they are dealing, for instance, in deflated 1933 dollars when cash is received. While an exchange of property is more complex in that the current value of the item received may not be self-evident, the same principle applies.

Plaintiff cites two recent cases which it claims support its point that an item, particularly stock, need not be taken into income at its value on the date on which it is includable in income. *White Farm Equipment Co.* v. *Commissioner of Internal Revenue*, 61 T.C. 189 (1973), *rev'd sub nom.*, *Amerada Hess Corp.* v. *Comm'r*, 517 F. 2d 75 (3d Cir. 1975),[5] while relevant on the subject of valuation, does not at all sustain taxpayer on the date-of-valuation issue. In *White Farm*, the court clearly viewed the proper valuation date as October 31, 1960, the day on which shareholders of both companies approved the agreement, and felt called upon to determine the proper value of the stock received as of that date. 61 T.C. at 214-15; 517 F. 2d at 83, n. 29. Whatever the correctness of the court's determination of the value as of October 31, 1960, that was plainly chosen as the valuation date.

The other case is *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis. 1973), *aff'd per curiam*,

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[5] The Third Circuit decision in *White Farm*, which reaches a result similar to that we reach, issued subsequent to the preparation of this opinion. While that decision supports our reasoning, we have reached our conclusion independently.

500 F. 2d 44 (C.A. 7 1974), in which plaintiff trucking company sold all its assets to a second company, CW Transport, Inc., in return for cash and stock in CW. The agreement, which was subject to approval by the I.C.C., provided that CW would take control of the assets and the assets would be appraised to set a firm sales price as soon as possible after temporary approval of the I.C.C. was received, but that title would not actually pass in either direction until the I.C.C. granted permanent authority. Following I.C.C. temporary approval on March 26, 1968, CW, on April 1, took over all plaintiff's assets and customers, and replaced all officers and all but one director. By agreement, all profits and losses of the business after April 1 were CW's, and plaintiff received interest on the purchase price—the value of the assets as of April 1—from that date until final settlement. ICC permanent approval followed, and the agreement was formally closed on August 30. The market price of CW stock had increased substantially between April 1 and August 30, and after plaintiff valued the shares as of the earlier date, the Service assessed a deficiency, claiming that the later time was proper for valuation. The District Court found that, while ICC approval was not a mere formality, it was so likely that everyone—the stock market, the industry, and most important the parties—treated the transfer as completed on April 1. In those circumstances, the court found that equity compelled a finding that the shares had been effectively transferred on April 1, and the value on that date should control.

The critical difference between *Herbert J. Investment* and the present case is that in the former the parties did not wait for final ICC approval to close the transaction but effectively closed it as of April 1st and deemed it permanent as of that time. As the District Court pointed out (360 F. Supp. at 827-28), the "consummation itself [after final ICC approval], however, was actually nothing more than formalization of the arrangement effected by the parties on April 1," and the parties "fully committed themselves to the impact of their agreement on April 1, 1968, and treated the possible failure of final approval as a real, but highly unlikely, condition subsequent. * * * The time of transfer of dominion and control over assets which are the subject of a sale is a more important consideration than the time of ultimate payment or conveyance of formal title."

Here, on the other hand, no effort was made to close in any way before the vote of the Mesabi stockholders on April 22, nor was it ever contemplated that the actual closing could or would precede that event. The parties were very careful not to disturb the main bargaining counters each had—the lawsuits—until after shareholder approval. The agreement's provision that closing would be delayed for five days after approval was related to this decision. No stock or money changed hands before April 22. Reserve's plans for expansion, though announced between the signing of the agreement and the Mesabi stockholders' meeting, stated that expansion would be undertaken "[*i*]*f* the settlement is made as contemplated, * * *" (emphasis added). The shareholders' approval was treated throughout as a most significant condition precedent, not as a condition subsequent as in *Herbert J. Investment*. In short, while the present parties could have presented us with a case like that one, they have not.

We add that here stockholder approval, though probable, was surely not a mere formality. Mesabi stockholders had not been a docile group, as the 1958 proxy fight showed, and major blocks of shares were still in the hands of persons associated with old management. Furthermore, Mesabi had, on the record date for the vote, over 2700 individual and 250 institutional shareholders. Most of the shareholders had fewer than 100 shares, and no individual shareholder owned more than 37,154 shares directly. Since Mesabi had agreed to an absolute majority vote, non-voting shares were in effect voted against the agreement. While Mesabi's board of directors might have been convinced that those who voted would vote for the agreement, the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement. In fact, the agreement received the vote of only 87% of the eligible shares, not the 99.9% plaintiff has claimed.

Plaintiff has argued that acceptance of the accrual date as the valuation date leaves the parties unable to determine in advance the tax consequences of a transaction in which actively traded stock is exchanged. The point fails to recognize that the participants could agree on a purchase price and provide that it would be paid in "x" shares of stock at the market price on the final date of agreement plus or minus a cash balancer. There is no reason to believe that this formula was considered and rejected in this instance as infeasible. As the evidence and particularly the testimony of Mr. Jesse Climenko, plaintiff's counsel at the time, shows, Mesabi was not particularly interested in how many dollars it was receiving (beyond a certain minimal amount) but in ending Reserve's interest in Mesabi and in modifying the lease agreement. (Climenko, Tr. at 109–110.) Plaintiff, while it had concern for the tax consequences, had other thoughts uppermost in its corporate mind in February 1960, and should not be heard now to complain that, if it had wanted to, it could not effectively have arranged the transaction so as to predetermine the tax consequences.

Nor is it an adequate answer to say that the Treasury would not be harmed by allowing the parties to fix the value of transferred property at a time prior to and lower than the date-of-taking-into-income since a decrease in one side's tax (as here)[6] would be counterbalanced by an equivalent increase in the tax owed by the other side. That is not always true even if the Service manages to keep both taxpayers before it at the same time; the theoretical increase in tax for the one party may be washed out, in actual fact, by its own special circumstances. And in any event it would be a considerable administrative burden on the Service to ensure that in all such instances it kept the cases of the two (or several) taxpayers always in tandem so as to be able to collect, on balance, a tax based on the property's value at the date-of-taking-into-income. The general rule is that while the parties may be normally bound by the value agreed upon between them, the Service is not so restricted. *Commissioner* v. *Danielson*, 378 F. 2d 771, 774–75 (C.A. 3), *cert. denied*, 389 U.S. 858 (1967); *see Eckstein* v. *United States*, 196 Ct. Cl. 644, 655, 452 F. 2d 1036, 1042 (1971).

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[6] If the value of the property had increased by the time of taking into income.

## III

### *Value as of April 22, 1960*

Our decision that the stock received must be valued at its April 22, 1960 value does not decide what that value was. The starting place for discussions of value is of course the proposition that the "fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts." *Jack Daniel Distillery* v. *United States*, 180 Ct. Cl. 308, 315–16, 379 F. 2d 569, 574 (1967). Where stock is freely traded in an open, organized market, stock exchange quotations for the valuation date generally provide the best evidence of value.[7] *See Moore-McCormack Lines, Inc.* v. *Comm'r*, 44 T.C. 745, 759 (1965); *Southern Natural Gas Co.* v. *United States*, 188 Ct. Cl. 302, 351–52, 412 F. 2d 1222, 1252 (1969); 10 J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION §§ 59.13 at 42–43, 59.14 at 47 (1970). However, extraordinary circumstances relating either to the state of the market or to the shares actually being valued can make market quotations unreliable indicators of true value. *Taylor* v. *United States*, 33 AFTR 2d 74–1317, 1320 (E.D.N.C. 1974). Several possible factors have been discussed in this regard and plaintiff has, at various points in the proceeding, suggested that some may be applicable.

A. Primarily, plaintiff says that the shares should be valued by the "barter-equation method" in which the value of an item received in an arm's-length transaction is taken as equal to the value of the item given up. Under this theory the value which intelligent, knowledgeable parties with adverse interests put on an item should be regarded as the fair market value of that item, given the circumstances of the trade, since there usually is no other trade available for comparison which is identical in all respects. While the thought has some appeal, in all the cases we have been able to find in which it was used, the objective market price suffered from some deficiency not present here. *See*, *e.g.*, *Moore-McCormack Lines*, *supra* (market too "thin" to absorb shares; shares carried "a bundle of collateral rights"); *Southern Natural Gas*, *supra* (no recent sales of closely held stock). In the present instance, there is no comparable reason for rejecting the active trading price on the exchange on April 22; if plaintiff had chosen to reissue the shares at that time it would have gotten that price (as we show *infra*).

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[7] Plaintiff has not questioned defendant's use of the mean between the high and low price at which the shares traded on April 22 as a valid measure of the stock market price on that date, even though the calculation is found in the estate, rather than income tax, regulations. Treas. Reg. § 20.2031–2(b). Defendant's practice has been accepted as valid by the Tax Court in income tax proceedings, and, in the absence of any complaint by plaintiff, we are inclined to follow. *See Meyer* v. *Comm'r*, 46 T.C. 65, 106 (1966), *modified on other grounds*, 383 F. 2d 883 (C.A. 8, 1967).

We also find that plaintiff's position suffers from the fatal flaw that there was no clear agreement between the parties on the value of what was being exchanged. *See KFOX*, *Inc.* v. *United States*, 206 Ct. Cl. 143, 153–55, 510 F. 2d 1365, 1370–71 (1975); *Bar L Ranch Inc.* v. *Phinney*, 426 F. 2d 995, 1001 (C.A. 5, 1970). Unlike *Southern Natural Gas* and *Moore-McCormack*, *supra*, no value for the stock or for the items (release of claims) given in return was stated in the agreement. Nor did the agreement on its face tie the value of the shares to the then stock exchange price. There is absolutely no evidence in the record about what Reserve thought was the value of what it was receiving. There is no indication in the minutes of the February 19 Mesabi directors' meeting (although there is in Mr. Tanner's notes prepared for that meeting) that there was discussion of the $7,000,000 figure for the total value received. Similarly, the proxy statement is silent in this regard. And the validity of the $7,000,000 figure is certainly open to question in light of the fact that it includes only the pre-1960 royalty claims while, no matter how the agreement was in fact drafted, Mesabi was actually giving up its right to pursue its antitrust cases, and its claims for the premium value of the taconite pellets, claims which together exceeded $50,000,000. In addition, Mesabi received more than stock and money—it received the right to definite and certain royalty payments in a clearly determinable amount—a right which it had not had before and which was, in fact, a major objective of the bargain.

Even if plaintiff were to overcome this significant hurdle of lack of a clear agreement on value, the "barter-equation method" should not be used. As the Second Circuit noted in a similar case, that method

> is a means which should be used only under certain limited conditions. The authority for it comes almost exclusively from cases involving valuation of property for which there is little or no market; * * * There are obvious dangers in evaluating the consideration involved in one side of a barter by determining the worth of the consideration on the other side. In the first place, the two sides of the barter may, for various reasons, not be equal in value. Secondly, the barter-equation method is in the nature of a bootstrap operation since there is usually no logical reason to start with one side rather than the other. * * * Thirdly, the evidence on the value of one side of a barter may be no more reliable than that on the value of the other side.

*Seas Shipping Co.* v. *Comm'r*, 371 F. 2d 528, 529–30 (C.A. 2), *cert. denied*, 387 U.S. 943 (1967). All the problems highlighted by that court are present here.

First, there is the distinct possibility that the two sides of the barter were not equal in monetary value. According to the testimony of Mr. Climenko, Mesabi was most interested in two things: getting rid of Reserve's power over Mesabi by eliminating Reserve's stock ownership, and revising the lease agreement to give Mesabi an easily determinable royalty. The number of shares which Mesabi wanted to receive from Reserve was clear—all of them. What value each share had was, while not irrelevant, relatively unimportant, as was the total value. As one commentator has noted, "[W]hen shares are repurchased by a corporation from a dissenting stockholder, perhaps to get rid of him at any price [, the] stockholder might have been paid far more than his stock was worth, part of the payment actually representing nuisance value." Holzman, *When actual sales may not establish fair market value for securities*, 29 J. TAX 134, 135 (1968). Here, as there, the important objective was to separate the other side from the shares, not to get a price equivalent to the things given up by Mesabi.

Second, plaintiff has not supplied us with a good reason why we should value the stock by the claims rather than the other way around. This is not a situation where an independant appraisal of the value of the claims was available, so that doubts about the wisdom of using April 22 market quotations as the value of the stock could be resolved by reference to an independent estimate of the value of what Mesabi was giving up. And third, the value of what was exchanged for the stock here is, if anything, even more speculative than the value of the stock. In addition to the problem of determining exactly what was given up, plaintiff has produced testimony on the speculative nature of some of its claims, and has shown that even the value of the pre-1960 profit share claims is difficult to determine. There is, for example, no cogent evidence in the record of the exact value of the 1959 claim—all we know is that Reserve thought Mesabi entitled to $661,469, and that Mesabi thought "maybe we would have gotten $1,500,000, somewhere in that area" (Tanner, Tr. at 51). In the major case on the subject, *United States* v. *Davis*, 370 U.S. 65 (1962), the Court made no attempt to even try to determine directly the value of what the taxpayer had received (release of marital rights), but evaluated those rights by reference to the more easily ascertained value of the stock the plaintiff had given up. We think a similar solution is applicable here.

B. Restricted stock will frequently have a lower value than that traded on the exchange since it is by definition less marketable (*see, e.g.*, *Heiner* v. *Crosby*, 24 F. 2d 191, 193 (C.A. 3, 1928)), but there is no ground for reducing the value of the shares at issue simply because they were originally subject to the Delaware sequestration orders. The settlement agreement provided that the actions under which the shares were sequestered would be dismissed "at or prior to closing" and the sequestration order in the *Mesabi* v. *Reserve and Hindle* case (the only order in evidence) provided that upon dismissal of the action the shares would be released from sequestration. Furthermore, that same order provided that, on Reserve's direction, the stock could at any time be sold upon provision of equal security. Presumably, this provision would include a sale to Mesabi. In any event, the shares received were released from sequestration on April 25 and were received free and clear. Since the likelihood of the shares being obtained by Mesabi in restricted status was, by the terms of the settlement agreement, extremely small, we conclude that no deduction in the market price should be made on this account.

C. A corollary of the point just discussed is plaintiff's claim that the shares should be valued at a price other than the April 22d market price because they were not to be resold. But taxpayer had not entered into any binding agreement with anyone, including Reserve, to that effect. The cases cited are distinguishable in that there the parties exchanging the shares had agreed that the stock would not be resold or could be resold only under restrictive conditions. *See White Farm Equipment Co.*, *supra*, 61 T.C. at 201–02 (stock to be distributed to recipient's shareholders or sold in a public offering with no order for more than 10,000 shares filled); *Seas Shipping Co.* v. *Comm'r*, 24 CCH Tax Ct. Memo 1222, 1226 (1965), *aff'd*, 371 F. 2d 528 (C.A. 2, 1967), *cert. denied*, 387 U.S. 943 (1967) (shares to be held for investment and not resold). Moreover, plaintiff's action in early 1961 of floating a stock issue almost as large as the number of shares received from Reserve suggests that the plan to retire the shares permanently was not, in fact, fully realized.

D. Another point is that the market prices either should be discarded completely or discounted because they are not reflective of the price at which the extremely large block of stock involved here would have sold, a phenomenon known as "blockage." *See* Treas. Reg. § 20.2031–2(e). We note first that plaintiff has not objected to the trial judge's refusal, by implication, to find it entitled to a blockage discount. Our own analysis leads us to the same conclusion. While a large block of shares dumped on the market at one moment will ordinarily depress the market price for a time, *Seas Shipping Co.* v. *Comm'r*, *supra* 371 F. 2d at 530, the courts which have considered the blockage issue have concluded that the problem should be treated in terms of whether the market could have absorbed the shares within a reasonable period of time. *Richardson* v. *Comm'r*, 151 F. 2d 102 (C.A. 2, 1945), *cert denied*, 326 U.S. 796 (1946); *White Farm Equipment Co.*, *supra*, 61 T.C. at 215. In those cases in which either a blockage discount has been allowed or the market price disregarded entirely because too large a block was involved, the number of shares being valued was very much greater than the total shares traded in a year. *See, e.g.*, *Amerada Hess Corp.*, *supra*, 517 F. 2d at 87–88, 89–91, (665,000 shares being valued; 444,000 traded during entire year); *Moore-McCormack Lines*, *Inc.*, *supra*, 44 T.C. at 760 (300,000 shares being valued; 166,000 traded during entire year). In the present case, the record shows that the number of shares to be valued is smaller than that traded during the single month of March 1960. In the absence of any evidence from plaintiff to the contrary, we conclude that with this type of active market the shares could have been absorbed fast enough for a blockage discount to be inapplicable, and that the number of shares involved is not so large as to make the market prices inherently suspect.[8]

E. Plaintiff's final argument is one initially broached from the bench at oral argument on the earlier cross-motions for partial summary judgment. It was suggested then that, on analogy to condemnation cases, if plaintiff could prove that the increase in the value of the shares was a result of the settlement agreement, the fair market value for tax purposes might be considered the "pre-action" value, the worth as of February 18. Further reflection, aided by the presentations of the parties, has convinced us that the analogy is inapposite.

The Supreme Court has stated that in determining the amount due the owner of condemned property under the just compensation clause, "[it] is not fair that the government be required to pay the enhanced price which its demand alone had created. That enhancement reflects elements of the value that was created by the urgency of its need for the article. It does not reflect what 'a willing buyer would pay in cash to a willing seller,' in a fair market. * * * [T]he enhanced value reflects speculation as to what the government can be compelled to pay. * * * That is a value which the government itself created and hence in fairness should not be required to pay [citations omitted]." *United States* v. *Cors*, 337 U.S. 325, 333–34 (1949); *see United States* v. *Miller*, 317 U.S. 369, 375 (1943).

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[8] While defendant did not assess the shares at a value exceeding the market price, the fact that the block had substantial nuisance value and might in fact have been controlling if Reserve had pressed its position, tends to indicate that the chares might have had a premium rather than a depressed value. *See* 10 J. MERTENS, THE LAW OF FEDERAL INCOME TAXATION § 59.15 at 53 (1970); Treas. Reg. § 20.2031-2(e).

This rule excluding such "enhancement" has been limited, so far as we are aware, to condemnation cases, and there are several reasons why it should not be extended in plaintiff's favor. First of all, if the value of the shares was enhanced here because of the settlement agreement, that was due to the actions of both Mesabi (buyer) and Reserve (seller), and not that of the buyer alone; the increase was not attributable, as in the condemnation cases, to the buyer's special need for the property which itself pushed the price upwards. Second, it has not been proven what part of the increase was due to the settlement agreement and what part to Reserve's collateral but separate plan to increase production and to Mesabi's change-over from the corporate to the trust form. Third, Mesabi could, as we have discussed above, have resold the stock at its enhanced value and reaped the benefits of the enhancement. In a condemnation proceeding, on the other hand, the assumption is that, but for the condemnor's desire to acquire, the property could not have fetched the premium value claimed for it. If it were not for the "enhancement-exclusion" rule, the public authority would have to pay an extra sum, attributable to its announced need, which it would be unlikely to recoup or obtain any value for. The principle is one of fairness to the condemnor and at the same time to the condemnee. Finally, we note that Mesabi was the recipient of the higher-value shares without being required to pay more than had been agreed on February 19, 1960, for those shares. This is the result the non-enhancement principle yields in the condemnation cases, and there is no need to tack on extra benefits to the buyer by taxing him at the lower value though he received and could take advantage of the higher.

Our conclusion, then, is that plaintiff has not produced any adequate reasons why we should disturb the defendant's determination that the traditional basis for valuation of widely-held stock should be used. We hold that the value of the stock Mesabi received was, on April 22, 1960, the mean of the high and low prices at which the stock was sold on the American Stock Exchange on that day, $78¼.

The taxpayer is not entitled to recover and the petition is dismissed.

KASHIWA, *Judge*, dissenting:

I respectfully dissent from the majority for the reasons hereinafter stated.

26 U.S.C. § 1001(b) (1970) provides, as pertinent herein, that the "amount realized from the sale or other disposition of property shall be the sum of any money received plus the *fair market value of the property* (other than money) received." [Emphasis supplied.] Under this basic section, the present case turns out to be a simple stock valuation case. There is no dispute in this case as to when income was to be reported so we are not concerned with the date on which all the events had occurred which would require Mesabi to accrue the value of the stock as income.[1] Our sole concern is the "market value" of the stock.

In *Jack Daniel Distillery* v. *United States*, 180 Ct. Cl. 308, 315–316, 379 F. 2d 569, 574 (1967), we stated that:

> * * * The legal definition of fair market value is the price at which property would change hands in a transaction between a willing buyer and a willing seller, neither being under compulsion to buy or sell, and both being reasonably informed as to all relevant facts. *Wood* v. *United States*, 89 Ct. Cl. 442, 29 F. Supp. 853 (1939). [Footnote omitted.]

This definition is identical to that in *United States* v. *Cartwright*, 411 U.S. 546, 551 (1973). See, also, *White Farm Equipment Co.* v. *Commissioner*, 517 F. 2d 75 (3d Cir. 1975),[2] *rev'g*, 61 T.C. 189 (1973), where the same *Cartwright* decision of the Supreme Court is referred to and the decision of the Third Circuit is based on this fundamental principle.

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[1] Treas. Reg. § 1.451-1(a) (1960) which states in pertinent part:

"* * * Under an accrual method of accounting, income is includible in gross income when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy. * * *" This regulation is issued under Int. Rev. Code of 1954, § 451 entitled "General Rule for Taxable Year of Inclusion." The focus under § 451 is only upon when income is to be reported. Section 451 is simply an accounting standard used to determine the year in which income is to be reported. The majority seems more concerned with this accounting standard than with what 26 U.S.C. § 1001(b) (1970) above quoted basically provides.

[2] Consolidated with *Amerada Hess Corp.* v. *Commissioner*, No. 74–1633 and No. 74–1634.

The majority properly finds in its opinion portion of the decision (as distinguished from the findings of fact) that plaintiff and Reserve entered into an agreement:

> On February 18, 1960, the negotiators reached an agreement under which Mesabi would receive $400,000 and all of Reserve's stock in Mesabi (now 163,570 shares, *see* footnote 1, *supra*). Mesabi would drop all claims against Reserve, its shareholders, and Hindle, and the 1939 agreement would be modified to provide Mesabi with royalties of $1.00 per adjusted ton of taconite concentrate shipped. At Reserve's request, the agreement provided that it would not become effective until approved by a majority of Mesabi's outstanding shares but that the shares held by Reserve could not be voted nor counted toward the majority. The closing was to take place on the fifth business day following approval by Mesabi's shareholders.

It is important to note the majority also found specifically in its findings-of-fact portion of the decision that a price of $40 3/8 per share was "considered by the taxpayer's board of directors at their February 19, 1960 meeting" (Findings ¶52) when they considered and approved the settlement (Findings ¶¶32, 35). The majority further found that at that meeting the board of directors was advised by counsel "that $7,000,000 was the maximum amount that reasonably could be expected for [Mesabi's] pre-1960 claims" (Findings ¶35) and that in satisfaction of those claims Mesabi was receiving $400,000 cash plus Mesabi stock worth $6,600,000 being the 163,570 shares of Mesabi stock at $40 3/8 per share, thereby realizing what was essentially a complete victory with respect to its pre-1960 net profits claims (Findings ¶35). These findings are recited here because the majority after making these findings should not overlook the rest of the record in this case.

An examination of the entire record in this case shows that the evidence is clear, compelling, conclusive, and uncontradicted that the 163,570 Mesabi shares were valued on a $40 per share basis. There are 142 pages of uncontradicted testimony by witnesses Lester J. Tanner and Jesse Climenko in the record which clearly prove this. Furthermore, the fact that $40 was used as the per share value is supported not only by parol evidence but by documentary evidence received in evidence at the trial, plaintiff's Exhibit B. Added thereto, witness Lester J. Tanner explained in connection with Exhibit 58 the $7,000,000 settlement figure. Up until 1956 Reserve incurred operating losses which it claimed to be $18,421,844.23. Mesabi claimed they were $15,314,582.19. The losses had to be recovered from profits before Mesabi could get its one-third share. An agreement was made whereby the losses would be amortized over a 13-year period so that if every year there were profits over and above one-thirteenth of the pre-production losses, Mesabi would get royalties. An amortization of $15,314,582.19 at one-thirteenth a year for 1956, 1957, and 1958 would leave $11,780,447.85 in unamortized losses. Therefore, one-third would have to be deducted from the balance due Mesabi: $9,808,542.70 − $3,926,815.95 = $5,881,726.75. To this, add the claim for 1959 of approximately $1,500,000, resulting in a total of $7,381,726.75. This conclusively shows that $7,000,000 was the settlement figure based on concrete figures.

In view of the clear record in this case above pointed out, it is difficult to depart from the conclusion that the parties intended the transaction to be $400,000 plus 163,570 shares at $40⅜ for claims worth about $7,000,000. The arithmetic below cannot be denied:

| | | |
|---|---|---|
| 163,570 shares at $40⅜ | = | $6,604,138.75 |
| Cash paid | = | 400,000.00 |
| | | $7,004,138.75 |

This arithmetic is not a pure coincidence because $40⅜ was the market price of Mesabi shares on February 19. Where the evidence is undisputed and the results are supported by plain arithmetic, there was only one conclusion the majority could have reached—the agreement and bargain of the parties necessarily included the value of $40⅜ per share.

Under any written contract, consideration if not recited in the contract may be proven by parol evidence. *Bernatschke* v. *United States*, 176 Ct. Cl. 1234, 1239–40, 364 F. 2d 400, 404–405 (1966); *Paccon, Inc.* v. *United States*, 185 Ct. Cl. 24, note 11, 399 F. 2d 162, note 11 (1968). Although the value of the 163,570 Mesabi shares was not recited, it was proven by parol evidence. The trial judge allowed 147 pages of testimony to prove that the shares were valued at $40 per share, the February 19 value. Documentary evidence was also allowed to fully corroborate the parol proof. Such proof uncontradicted is equivalent to a full recital of the consideration in the contract.

In tax cases where parties to a contract agree to a price, courts will let the contract price stand. This is a rule of much significance because the Supreme Court in *United States* v. *Davis*, 370 U.S. 65 (1962), used the above-mentioned rule to partially reverse a prior opinion of this court, *Davis* v. *United States*, 152 Ct. Cl. 805, 287 F. 2d 168 (1961). The Court stated at 72–73:

> It must be assumed, we think, that the parties acted at arm's length and that they judged the marital rights to be equal in value to the property for which they were exchanged. *There was no evidence to the contrary here.* Absent a readily ascertainable value it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States*, 130 Ct. Cl. 166, 172, 126 F. Supp. 184, 189 (1954), that the values "of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal." Accord, *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (C. A. 6th Cir. 1960); *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (C. A. 2d Cir. 1943). To be sure there is much to be said of the argument that such an assumption is weakened by the emotion, tension and practical necessities involved in divorce negotiations and the property settlements arising therefrom. However, once it is recognized that the transfer was a taxable event, it is more consistent with the general purpose and scheme of the taxing statutes to make a rough approximation of the gain realized thereby than to ignore altogether its tax consequences. Cf. *Helvering* v. *Safe Deposit & Trust Co.*, 316 U.S. 56, 67 (1942). [Emphasis supplied.]

The rule has since been followed by this court. See *Davee* v. *United States*, 195 Ct. Cl. 184, 444 F. 2d 557 (1971); *Republic Steel Corp.* v. *United States*, 94 Ct. Cl. 476, 40 F. Supp. 1017 (1941); *Annabelle Candy Co.* v. *Commissioner*, 314 F. 2d 1 (9th Cir. 1962); *Ullman* v. *Commissioner*, 264 F. 2d 305 (2d Cir. 1959). And more recently, this court stated in *KFOX*, *Inc.* v. *United States*, 206 Ct. Cl. 143, 153, 510 F. 2d 1365, 1370 (1975):

> When two parties to the sale of assets explicitly allocate the aggregate purchase price to the various assets being sold, the valuation they put on each asset will usually be accepted for tax purposes so long as the parties have opposing tax positions and have acted *without collusion or fraud and the allocation is not so disproportionate as to be unreasonable. Davee* v. *United States*, 195 Ct. Cl. 184, 444 F. 2d 557 (1971); *Republic Steel Corp* v. *United States*, 94 Ct. Cl. 476, 40 F. Supp. 1017 (1941); *Annabelle Candy Co.* v. *Commissioner*, 314 F. 2d 1 (9th Cir. 1962); *Ullman* v. *Commissioner*, 264 F. 2d 305 (2d Cir. 1959). To the extent, therefore, that the parties agreed to allocate and in fact did allocate the aggregate price over all of the assets we would be constrained to follow that allocation as the basis to be applied in depreciating those assets. * * * [Emphasis supplied.]

There is no finding of collusion or fraud by the majority. The exchange quotation of Mesabi shares was at $40⅜ on February 19 so there is nothing disproportionate in using a $40 figure.

The majority's reason for departing from the $7,000,000 agreement is the following:

> * * * And the validity of the $7,000,000 figure is certainly open to question in light of the fact that it includes only the pre-1960 royalty claims while, no matter how the agreement was in fact drafted, Mesabi was actually giving up its right to pursue its antitrust cases. and its claims for the premium value of the taconite pellets, claims which together exceeded $50,000,000. In addition, Mesabi received more than stock and money—it received the right to definite and certain royalty payments in a clearly determinable amount—a right which it had not had before and which was, in fact, the major objective of the bargain.

The $7,000,000 figure is not open to question because it was agreed upon by the parties and since there is no fraud or collusion, it should not be disturbed. As for Mesabi's rights to receive royalty payments for the iron ore, the prior lease agreement provided for a percentage-of-profit type of payment. The new agreement provided for a fixed amount per ton. It was a mere substitution of one method of computation over another. The majority opinion sounds as if an entirely new source of income was provided. This was not so. The antitrust claims were valued at zero at the request and insistence of Reserve (Tr. 129–130). The parties so decided and we should not engage in the revaluation of antitrust claims, a task most difficult and extremely speculative.

The majority treats the shareholder approval in this case as a condition precedent. I quote:

> * * * The shareholders' approval was treated throughout as a most significant condition precedent, not as a condition subsequent as in *Herbert J. Investment.* In short, while the present parties could have presented us with a case like that one, they have not.

The majority evidently missed a material point in the transcript. Under the laws of the State of Delaware, where Mesabi was incorporated, it was not necessary to obtain shareholder approval of the February 19 settlement agreement. The board of directors of Mesabi had the authority to enter into the agreement without shareholder approval (Tr. 71–72). The provision as to Mesabi shareholder approval was put in the settlement agreement only at the request of Reserve.

A careful reading of the agreement, therefore, shows that the parties entered into a binding agreement when they signed the agreement. But they were to be discharged of their assumed obligations if the shareholders' approval did not take place. I incorporate the material portions of the agreement to show that a condition subsequent was intended.[3]

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[3] The material portions of the agreement of February 19, 1960, were as follows:

"1. Subject to the conditions hereof Mesabi and Reserve shall, at the Closing, execute and deliver an instrument in the form of Exhibit A hereto to amend the Assignment and an instrument in the form of Exhibit B hereto to amend the Mesabi Lease, * * *.

"2. Subject to the conditions hereof Reserve shall, at the Closing, (a) pay to Mesabi $400,000, and (b) assign to Mesabi all of Reserve's right, title and interest in all of the shares of common stock of Mesabi owned by Reserve (which Reserve represents total 163,570 shares). * * *.

"3. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall cause the above-mentioned arbitration proceedings to be terminated.

"4. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall (a) stipulate for the dismissal with prejudice of all pending actions or counterclaims of either of them against the other, its present and former officers, directors or stockholders, and (b) cause to be dismissed by

(Continued)

The language of paragraph 9 of the agreement, which reads as follows:

> 9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stockholders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders.

clearly shows a present obligation to be discharged upon the nonoccurrence of the condition subsequent; to wit, disapproval by the shareholders.

Furthermore, as a part of the record in this case, Gilbert M. Haas, in Answer to Interrogatories,[4] filed December 30, 1970, stated as follows:

> Moreover, Reserve was not concerned about the outcome of a vote by the Mesabi shareholders. Mr. Arnold Hoffman and I were in constant communication with the principal shareholders of Mesabi, and as a result of our close contact with the shareholders we were able to

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(Continued)

stipulation of the necessary parties thereto, or move to dismiss, the abovementioned *Putterman* v. *Daveler* action and take all steps reasonably necessary to secure a prompt dismissal of such action.

"5. Subject to the conditions hereof, effective at the Closing, each party hereby releases the other party, its present and former officers, directors and stockholders in whatever capacity, from all claims, demands, actions or causes of action of any kind or nature, * * *.

* * * * *

"8. Performance of the obligations of Mesabi and Reserve set forth in paragraphs 1 through 5 above are subject to the conditions that approval and authorization shall have been given by the affirmative vote of a majority of all the outstanding shares of Mesabi, excluding from such majority the shares owned by Reserve.

"9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stockholders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders."

[4] Made part of the record by Plaintiff's Motion for Partial Summary Judgment, filed October 20, 1971. See, also, pages 7 to 11 of the uncontradicted Affidavit of Gilbert M. Hass, attached to said motion as an exhibit. See Rule 88(a) of this court.

> assure the officers of Reserve, that the shareholders of Mesabi would overwhelmingly accept and approve the terms of a Settlement Agreement recommended by the Mesabi Board of Directors. In fact, it was not until after I personally assured Mr. William Bryant, an officer of Reserve, in December 1959 that it was an absolute certainty that the shareholders of Mesabi would accept and approve the terms of any settlement recommended by the Mesabi Board of Directors, that negotiations for settlement were initiated and seriously pursued by Reserve. [At p. 3.]
>
> * * * * *
>
> While I am unable to recall with particularity the names and holdings of many of the other stockholders who were contacted during the period February 20, 1960, through March 4, 1960, I attempted to record in my diary many of the names of the Mesabi shareholders or representatives with whom I talked during this time period. I have attached copies of the pertinent diary pages. However, at this late date I am unable to recall the specific holdings of these individuals or representatives, nor am I able to relate many of the names with the owners of record contained in the list of stockholders being supplied by Bankers Trust Company, because the majority of the principal shareholders held their shares in "street name" and under various nominees. In any event, I do recall that all the people with whom I talked approved the terms of the Settlement Agreement and that their holdings, coupled with the holdings of Messrs. Joseph, Mudd, Fine, the individual directors of Mesabi and the Axe-Haughton Fund, represented more than two-thirds of Mesabi's total 1,323,794 outstanding shares, excluding the 163,570 shares owned by Reserve. * * * [At p. 7.]

The above answer by Gilbert M. Haas clearly shows that shareholder approval was only a technicality, just as much as the Interstate Commerce Commission's final approval was a technicality in *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis. 1973), *aff'd per curiam*, 500 F. 2d 44 (7th Cir. 1974).

The agreement of February 19, 1960, was signed by Mesabi's authorized officer on February 28, 1960, and by Reserve's authorized officer on March 2, 1960. When the document was signed on the respective dates by Mesabi's officer and Reserve's officer, they knew that shareholder approval was forthcoming and that shareholder approval was just a technicality. Gilbert M. Haas was elected a director of Mesabi in 1958 and he worked closely with Arnold Hoffman, president of Mesabi, in 1958, 1959, and 1960. The majority's following finding and conclusion regarding stockholder approval were in error:

> We add that here stockholder approval, though probable, was surely not a mere formality. Mesabi stockholders had not been a docile group, as the 1958 proxy fight showed, and major blocks of shares were still in the hands of persons associated with old management. Furthermore, Mesabi had, on the record date for the vote, over 2700 individual and 250 institutional shareholders. Most of the shareholders had fewer than 100 shares, and no individual shareholder owned more than 37,154 shares directly. Since Mesabi had agreed to an absolute majority vote, non-voting shares were in effect voted against the agreement. While Mesabi's board of directors might have been convinced that those who voted would vote for the agreement, *the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement.* In fact, the agreement received the vote on only 87% of the eligible shares, not the 99.9% plaintiff has claimed. [Emphasis supplied.]

They are completely contrary to Gilbert M. Haas' statement. The majority's finding that "the failure, through disinterest or inadvertence, of small shareholders to vote could have prevented ratification and must be considered a risk to final approval of the agreement," the portion I have emphasized in the above quotation, is contrary to Mr. Haas' statement in the record. To substantiate Mr. Haas' statement, there is a reproduction of many pages from his memorandum book showing the names of shareholders he called.

In concluding, it is submitted that it is the record that counts and this dissent is based on the record.

## FINDINGS OF FACT

The court, having considered the evidence, the decision and findings of Trial Judge Lloyd Fletcher, and the briefs and arguments of counsel, makes findings of fact as follows:

1. The plaintiffs in this action are trustees under an agree-

ment of Trust dated as of July 18, 1961, entered into under the laws of the State of New York by and between Mesabi Iron Company (hereinafter also referred to as taxpayer), party of the first part, and Bankers Trust Company, Arnold Hoffman, Arthur G. Logan, Gilbert M. Haas, and Earl Knudsen, as trustees, parties of the second part. Upon the deaths of Arnold Hoffman and Arthur G. Logan, Francis D. Butler and Norman F. Sprague, Jr. became trustees. The Agreement of Trust provides that the trust established thereby may be known as the "Mesabi Trust."

The facts of the case have been largely stipulated. Also, they have been in part recited by the court in its opinion dated May 12, 1972, dealing with cross-motions for partial summary judgment, in which opinion the court returned the case to the commissioner for trial and a fuller development of the relevant facts. *Bankers Trust Co., et al.* v. *United States*, 198 Ct. Cl. 306, 459 F. 2d 484 (1972).

**2.** The Mesabi Iron Company was incorporated under the laws of the State of Delaware in December 1919. At the time of its incorporation, taxpayer acquired, in consideration for the issuance of its stock, fee ownership of a 5,700-acre tract of land (hereinafter referred to as the "Mesabi Lease Land") in the Mesabi Iron Range in northern Minnesota, and a leasehold interest in two tracts of land—one of 720 acres (hereinafter referred to as the "Cloquet lease"), and the other of 9,000 acres (hereinafter referred to as the "Peters lease"), also located in the Mesabi Iron Range and containing extensive deposits of low grade iron ore. Mesabi also received an option to purchase an interest in the Dunka-Mesaba Security Company, fee owner of the Peters lease. Mesabi partially exercised the option in 1921, and acquired a 20% stock interest in the company. By 1951, and continuing to the time of the Settlement Agreement, Mesabi held a 20% undivided interest in the Peters lease land. Royalties were paid to Mesabi on a per-ton basis as fee owner. Mesabi's fee ownership and the royalties associated with it were not affected by the Settlement Agreement and are not at issue here.

**3.** The mineral deposits found in the leased lands, including the Peters and Cloquet leases, consisted of sedimentary beds of banded magnetite in silicious gangue known as taconite, lying nearly flat, without rock cover, and with light overburden of glacial drift. A 1931 report prepared for taxpayer estimated the mineral deposit contained at least 1,500,000,000 tons of minable raw material capable of yielding a minimum of 500,000,000 tons of concentrated product.

**4.** After its incorporation, taxpayer made an effort to exploit its Mesabi range iron ore deposits, expending approximately $6,400,000 in cash in the development of the enterprise. For various reasons, however, taxpayer was unable to concentrate the iron content of the ore on a profitable basis and consequently suspended all mining operations in May 1924. Mining of these iron ore deposits was not commenced again until 1956.

**5.** On March 31, 1939, the total liabilities of Mesabi, including borrowed funds and interest thereon, amounted to approximately $258,000. In order to pay its debts and also to provide for the future development of the iron ore deposits, taxpayer undertook negotiations with Reserve Mining Company (Reserve), a newly formed Minnesota corporation organized by Oblebay, Norton & Co., a firm engaged in the business of mining and selling iron ore from the Lake Superior district. Oglebay, Norton & Co. organized Reserve for the purpose of developing the Mesabi properties. The original stockholders of Reserve, as of October 6, 1939, were: Armco Steel Corporation (Armco) (33⅓ percent), Wheeling Steel Corporation (33⅓ percent), Montreal Mining Company (23⅓ percent), and Cleveland-Cliffs Iron Company (10 percent). Subsequently, changes in the stock ownership of Reserve occurred and, from January 3, 1952, to the present, Armco and Republic Steel Corporation (Republic) have each owned a one-half interest in Reserve.

**6.** At a special meeting held on June 28, 1939, the Mesabi stockholders adopted a resolution authorizing the board of directors and the proper officers of Mesabi to grant Reserve an option to acquire by assignment the Peters and Cloquet leases and to lease from Mesabi all the Mesabi lease lands. Mesabi granted such an option to Reserve on July 25, 1939, and Reserve exercised the option on October 17, 1939. Pursuant to its agreements with Mesabi, Reserve paid Mesabi $269,491.04 to satisfy Mesabi's liabilities, including those which had accrued to the date of the exercise of the option. Once Reserve exercised its option, it was thereafter in possession of substantially all of Mesabi's property.

7. The assignment of the Peters lease provided, among other things, that Reserve would pay to taxpayer 33⅓ percent of the net profits, as defined in the agreement, received by Reserve each calendar year from its operations carried on under the Peters lease. The lease of the Mesabi Lease Lands (hereinafter referred to as the Mesabi lease) provided in part as follows:

> The parties * * * recognize that it is impossible to set any definite basis of determining the price at which products from the lands covered by the Peters lease or this lease shall be sold but it is the intent of the parties hereto that in the sale of products from the lands covered by the Peters lease and this lease that the Lessee shall endeavor to procure the highest current price known to exist in an independent competitive market for material of like value in use and for like quantities. The Lessee shall not in any of its transactions under said Peters lease or this lease intentionally subordinate the interest of the Lessor [taxpayer] to the interest of any shareholder or shareholders or affiliate of the Lessee or any other person, firm or corporation.

The Mesabi lease also provided for the establishment of a permanent board of arbitration, consisting of a representative from both the taxpayer and Reserve. The lease provided that the arbitration board would have the power as follows:

> * * * [U]pon the written concurrence of both of its members, to determine every question which may arise under this lease or under said assignment of the Peters Lease or said Cloquet Lumber Company Lease. If they fail to agree they shall name a disinterested third party, and the question in dispute shall be submitted to the three, and a decision of a majority thereof shall be final and binding upon both parties; * * *.

8. During 1942, 1943, and 1944, Reserve purchased from third parties 148,700 shares of taxpayer's capital stock at a cost of $211,935.50. These purchases were made on behalf of Reserve by Raymond B. Hindle through Hayden, Stone & Company, a New York stock brokerage house. The purchases were made through private transactions and also

through the American Stock Exchange (formerly the Curb Exchange). The purchases were made in such a manner as to reduce the chance that market analysts would take notice of Hayden, Stone's purchasing efforts. Transactions were made in small share amounts and no standing "buy" orders were placed. During the time of these purchases, Mr. Hindle was the comptroller of Hayden, Stone & Company and was also secretary-treasurer and a director of taxpayer. The purchases were recorded by Hayden, Stone & Company in a numbered account.

**9.** During the years 1942, 1943, and 1944, Mr. Hindle advised the officers and directors of taxpayer as to Reserve's purchases of taxpayer's capital stock from third parties, so that by the end of 1944 taxpayer's officers and directors knew that Reserve had purchased 148,700 shares of Mesabi stock. Though many more shares of Mesabi common stock than that purchased by Reserve were available for purchase on the open market during the years 1942, 1943, and 1944, taxpayer had no funds available for the purchase of such stock.

**10.** After World War II, representatives of Reserve on numerous occasions discussed with representatives of taxpayer the possibility of modifying the Mesabi lease and the assignments of the Peters and Cloquet leases by, among other things, changing the provisions providing for taxpayers to receive one-third of Reserve's net profits from Reserve's operations under the Peters lease to provide for taxpayer to receive a fixed royalty. Between 1947 and 1952, several offers and counter-offers regarding an appropriate royalty figure were made, but the parties were unable to reach an agreement. Throughout this period, taxpayer's officers and directors were of the opinion, and communicated such opinion to Reserve's representatives, that any substantial modification of the taxpayer-Reserve agreements would require approval of taxpayer's stockholders.

**11.** Between 1951 and 1956, Reserve constructed (1) a power plant, concentrator, and pelletizing plant at Silver Bay, Minnesota, on Lake Superior; (2) a gyratory crusher at Babbit, Minnesota, a mine site on the Mesabi Range; and (3) a 47-mile railroad from Babbit to Silver Bay. The original capital costs to Reserve were approximately $178,000,000. Of this capital $35,000,000 was advanced by Reserve's two stockholders, Republic and Armco, and the remaining $143,000,000 was borrowed by Reserve from institutional investors. These loans were secured by a mortgage on substantially all of Reserve's properties and interests, including the 148,700 shares of Mesabi stocks owned by Reserve. Reserve also assigned to the trustee for the institutional investors a 1953 ore agreement between Reserve, Republic, and Armco. Under this ore agreement, Republic and Armco were obligated (1) to accept all the iron ore produced or mined by Reserve each year and (2) to reimburse Reserve for all of its costs and expenses. The ore agreement also provided that current market value was to be used, in lieu of actual reimbursement to Reserve, for all purposes in determining the payments to be made to taxpayer under the Mesabi lease and assignments of the Peters and Cloquet leases.

**12.** Reserve resumed mining operations on the Peters lease lands in 1956. By that time, due to the depletion in the United States of direct shipping ores (ores which could be shipped directly from the mine for use in a blast furnace and which contain approximately 50 percent iron content), deposits of low content ores, including taconite, had become important to consumers of iron ore. Processes had also been developed to treat and concentrate low grade ores, including taconite, by crushing, grinding, concentrating and other methods, to produce ore concentrates of sufficiently high iron content to be usable in the production of iron and steel. Methods had also been developed to process the concentrated ore into pellets. The taconite pellets produced by Reserve contained approximately 61 percent iron content. When mixed with natural iron ores or used exclusively in a blast furnace, these taconite pellets effected substantial savings in the cost of producing pig iron due to their uniformly high iron content and the uniformly excellent structure of the pellets. Mesabi consistently maintained during the period prior to the Settlement Agreement that if an open market had existed for the taconite pellets, Reserve's pellets would have been purchased at a price substantially higher than that paid for direct shipping ores of equivalent iron content.

**13.** The gross tonnages of crude ore processed by Reserve from the Peters lease lands and the gross tonnages of pellets shipped by Reserve from 1956 through 1959 were as follows:

| *Year* | *Gross Tonnages of Crude Ore Processed* | *Gross Tonnages of Pellets Shipped* |
|---|---|---|
| 1956 | 10, 933, 769 | 3, 497, 430 |
| 1957 | 14, 374, 255 | 5, 027, 557 |
| 1958 | 13, 111, 803 | 5, 031, 951 |
| 1959 | 10, 175, 897 | 3, 968, 463 |
| Total | 48, 595, 724 | 17, 525, 401 |

The total production was sold to Republic and Armco.

**14.** Commencing in the year 1953 and for each year thereafter through the year 1959, Reserve submitted to taxpayer reports of its operations carried on under the Peters lease. Upon submission by Reserve to taxpayer of the report for 1953 and for each report thereafter, taxpayer notified Reserve that it did not accept the reports as complying with the terms of the Mesabi lease and the assignments of the Peters and Cloquet leases. Consequently, numerous disputes arose between taxpayer and Reserve as to the correctness of Reserve's computations of the results of its operations under the Peters lease from which the taxpayer was to receive one-third of the net profits.

**15.** On May 4, 1955, taxpayer requested arbitration in accordance with the arbitration clause of the Mesabi lease (see finding No. 7), as to the proper treatment to be accorded Reserve's operations during 1953 and 1954. By letter dated November 15, 1955, Reserve also made a formal demand for arbitration. Just prior to the date when hearings before the board of arbitration were scheduled to begin, the parties entered into a settlement agreement, dated February 14, 1956, regarding the net losses incurred by Reserve from 1953 to 1955. This agreement provided (1) that the net losses for the period prior to January 1, 1956, when properly determined would be amortized in equal annual amounts over a thirteen-year period from 1956 to 1968, and (2) that any net losses of Reserve from operations under the Peters lease after January 1, 1956, when properly determined, would be applied against net profits thereafter accruing until such losses were recovered. In arriving at the amount of net profits which was to be split one-third to taxpayer and two-third to Reserve, taxpayer was to bear one-third of Reserve's accumulated net losses and Reserve was to bear two-thirds of its accumulated net losses.

**16.** At the time of the settlement agreement dated February 14, 1956, Reserve had taken the position that the accumulated net losses to December 31, 1955, amounted to $17,956,278.01. Thereafter, Reserve made revisions pursuant to the determinations of the board of arbitration on October 11, 1957, and adjusted accumulated net losses to December 31, 1955, to $18,421,844.23. As of the date of the settlement agreement, dated February 19, 1960, the amount of accumulated net losses remaining to be amortized, according to Reserve's computations, totaled $12,753,584.46 ($\frac{9}{13}$ of $18,421,844.23). Taxpayer asserted in the arbitration proceedings that the accumulated net losses to December 31, 1955, should be reduced to $15,314,582.19, and in accordance with taxpayer's position, the amount of accumulated net losses remaining to be amortized on February 19, 1960, totaled $10,602,403.02 ($\frac{9}{13}$ of $15,314,582.19).

**17.** Subsequent to the settlement agreement dated February 14, 1956, twenty-one questions were submitted to the two-man board of arbitration. On October 11, 1957, the two-man board issued five written determinations resolving some of the questions submitted. In a document dated October 30, 1957, entitled "Certification of Questions", the two-man board indicated that it had failed to resolve eleven of the questions submitted to it and consequently was referring those questions to a three-man board of arbitration.

**18.** In March 1957, Isaac Putterman, Robert L. Levine, and Barbara G. Mayer, stockholders of taxpayer, filed a derivative action in the Delaware Court of Chancery on behalf of taxpayer against Reserve and the then members of taxpayer's board of directors, seeking, among other things, an accounting with respect to the Mesabi-Reserve lease agreements, cancellations of the lease agreements, return of the property covered by the agreements to taxpayer, and a judgment against members of taxpayer's then board of directors for damages allegedly caused by their failure to prosecute taxpayer's claims against Reserve. The plaintiffs alleged that a proper accounting would disclose that Reserve was indebted to taxpayer in the approximate amount of $8,000,000 for operations during 1956. The plaintiffs in the derivative action attempted to obtain personal jurisdiction over Reserve, a non-resident, pursuant to 10 Del. Code § 366, and on March 25, 1957, the Delaware Court of Chancery appointed a sequestrator who subsequently sequestered the 148,700 shares of Mesabi stock owned by Reserve. The sequestration of the Mesabi stock was still in effect and the derivative action was still pending on February 19 and April 22, 1960.

**19.** Prior to the annual meeting of taxpayer's stockholders held on April 18, 1958, a proxy fight occurred within taxpayer. The central issue, asserted by a group led by Mr. Arnold Hoffman (now deceased) and Mr. Gilbert Haas, was the inability of existing management to represent adequately the interests of taxpayer's stockholders. Mr. Hoffman retained the New York law firm of Gallop, Climenko & Gould to assist him in the proxy contest. In a very close vote, 525,642 shares to 506,853 shares, new management headed by Mr. Arnold Hoffman won control of taxpayer even though Reserve voted its 148,700 shares in favor of taxpayer's old management.

**20.** In view of the voting by Reserve for old management and because of the prior failure of old management to obtain any favorable results for Mesabi in the arbitration proceedings, the new directors of Mesabi retained the law firm of Gallop, Climenko & Gould as general counsel and requested Mr. Jesse Climenko to make a thorough study of the Mesabi-Reserve arbitration proceedings. Upon completion of his study of the proceedings, Mr. Climenko concluded and recommended to Mr. Hoffman that Mesabi should extricate itself from the arbitration proceedings and pursue its claim for past profits in a court of law. Thereafter, taxpayer's management advised its stockholders that after reviewing the special counsel's report of the arbitration proceedings, "as well as fully considering Reserve's attitude as revealed in the recent discussions," the directors had concluded that in order to compel Reserve to make a strict accounting to taxpayer in accordance with its contractual obligations and obtain a ruling as to possible breaches of contract on Reserve's part, the most effective course of action was to present taxpayer's case in a court of law.

**21.** On June 13, 1958, Reserve filed an action in a Minnesota state court against taxpayer and the principal officers and all the members of taxpayer's board of directors to compel taxpayer to resume arbitration and to enjoin all action inconsistent with arbitration, or, in the alternative, to have the court determine the matters in dispute between the parties. On June 30, 1958, taxpayer's motion to remove the action to the Federal District Court for the District of Minnesota was granted. Taxpayer thereafter filed two counterclaims: the first sought damages from Reserve, Republic, and Armco in the amount of $16,166,667 as taxpayer's one-third share of the net profits from the operations under the Peters lease for the years 1956 and 1957; the second was brought under the Clayton and Sherman Antitrust Acts and sought treble damages of $37,500,000 from Reserve, Republic, and Armco. A principal reason for asserting the antitrust counterclaims, according to taxpayer, was to keep the case before a court of law and removed from the secrecy of the arbitration proceedings.

**22.** On March 30, 1959, the United States District Court for the District of Minnesota issued a memorandum order requiring Mesabi to return to arbitration, but at the same time, dissolved a restraining order previously issued by a Minnesota state court. The District Court ruled that the question of taxpayer's right to assert antitrust claims would be held in abeyance. On appeal, the Eighth Circuit Court of Appeals decided, on October 7, 1959, that taxpayer was entitled to a trial with respect to the defenses it asserted in response to Reserve's action to compel arbitration. Thereafter, the Minnesota District Court permitted taxpayer to file its counterclaim based on antitrust violations and further permitted the joining of Republic and Armco as additional parties to the litigation.

**23.** On June 16, 1958, taxpayer's new management advised taxpayer's stockholders that it was taking steps to assume the plaintiff's position in the stockholder derivative action pending in the Delaware court. Taxpayer also advised the shareholders that at a meeting with representatives of Reserve, Reserve had rejected a proposal to settle the taxpayer-Reserve differences by using the fixed royalty figure suggested by taxpayer, and that the nearest approach to a counterproposal by Reserve was a discussion of the fixed royalty figure which Reserve had suggested to taxpayer in 1950. Taxpayer advised its shareholders that Reserve's suggestion had been unacceptable to taxpayer in 1950 and if offered again by Reserve would likewise be rejected.

**24.** In April 1959, taxpayer instituted an action against Republic and Armco in the United States District Court for the District of Delaware alleging violations of the antitrust laws and seeking (1) treble damages of $67,500,000 and (2) a mandatory injunction requiring Reserve to offer the taconite pellets produced by it to any and all users or buyers thereof on a competitive basis. Taxpayer alleged that it had sustained damages of $22,500,000, the premium value of the taconite pellets of which it was being shortchanged on the accounting for profits. The Delaware District Court stayed the proceeding pending taxpayer's appeal to the Eighth Circuit from the Minnesota District Court's memorandum order. (See finding No. 22) This action was pending on February 19 and April 22, 1960.

**25.** In April 1959, taxpayer filed an action in the Delaware Court of Chancery against Reserve and Raymond B. Hindle seeking to obtain the 148,700 shares of Mesabi common stock (subsequently increased to 163,570 shares by reason of an 11 for 10 stock split on May 1, 1959) purchased by Reserve from third parties during the period from 1942 to 1944. Taxpayer was concerned that Reserve might again attempt to dominate taxpayer by voting the 148,700 shares (12.34 percent) of Mesabi stock which it held against taxpayer's interests and so viewed the lawsuit as a means of forcing Reserve to relinquish control of such shares. Taxpayer alleged that Reserve and Hindle conspired in the early 1940s to have Hindle violate his fiduciary duties to taxpayer by diverting to Reserve the opportunity to buy shares of Mesabi stock at favorable market prices and by withholding, during the period of the stock purchases, current material information concerning the status of Reserve's plans and operations in order to keep the market price of the stock at a low level. Taxpayer sought damages and losses as a result of the alleged breach of trust by Hindle and also sought to impose a constructive trust on the shares of Mesabi stock owned by Reserve. Taxpayer attempted to obtain personal jurisdiction over Reserve, a non-resident, pursuant to 10 Del. Code § 366, and the Court, on April 17, 1959, issued an order of sequestration with respect to the shares of Mesabi stock owned by Reserve. The sequestration order, while providing that all right, title and interest in the shares was in the sequestrator who was to hold and preserve them until further direction of the court, also provided that the shares could be sold upon direction from defendants upon provision of security of equal amount.

26. By January 1960, the three-man board of arbitration had completed hearings on all questions except the question of the propriety of Reserve's taconite pellet pricing on sales to Reserve's two stockholders, Republic, and Armco. On January 21, 1960, Wesley A. Sturges, the disinterested third arbitrator, ruled that Reserve should turn over to taxpayer Reserve's records dealing with pricing of taconite pellets charged to Republic and Armco. Thereafter, the hearings were adjourned until March of 1960 when testimony was to be taken on the question of pellet pricing. No decision was rendered by the three-man board on any of the questions submitted for arbitration.

27. Included among the questions pending before the three-man board of arbitration on February 19 and April 22, 1960, were those related to the following issues:

(a) The pricing by Reserve of pellets delivered by it to its two stockholders. Reserve in its reports to taxpayer used the price quoted in the ore market for Old Range Non-Bessemer direct shipping ore adjusted for iron content, whereas taxpayer claimed the pellets should have been priced at a substantial premium over prices paid for direct shipping ore.

(b) The deduction by Reserve of a tariff charge in lieu of the actual cost incurred for (1) rail haulage of semi-crushed ore from the crusher located near the mine to the site of later processing of the ore at Silver Bay, Minnesota,

(2) power generation at Silver Bay, and (3) dock and harbor operations.

(c) The deduction by Reserve of certain interest and finance costs.

28. The questions pending before the two-man board of arbitration on February 19 and April 22, 1960, included those relating to (a) deduction by Reserve of expenses of operating townsite properties; (b) deduction by Reserve of losses on the sale of townsite properties; (c) allocation by Reserve of income and expenses between properties covered by the leases and other properties operated by Reserve; (d) deduction by Reserve of depreciation on the milling and processing plant at Silver Bay; and (e) deduction and treatment by Reserve of management and other expenses, leasehold expenses, maintenance and repairs and Reserve's cost of arbitration.

29. (a) Taxpayer's claims for royalty income for the years 1956, 1957, and 1958, as set forth in the document entitled "Mesabi Iron Company Restatement of Net Profits of Reserve Mining Co. for Mesabi Report," and submitted to the board of arbitration, amounted to $9,808,542.70, not including taxpayer's claim that the taconite pellets should have been priced at a substantial premium over prices paid for direct shipping ore.

(b) Taxpayer, in its reports to its shareholders, consistently stated that the price at which Reserve sold the taconite pellets to its two stockholders (Armco and Republic) did not include any amount for the premium value of the pellets. According to taxpayer's expert, University of Minnesota Professor Thomas L. Joseph, a ton of pellets was worth from $4.27 to $4.37 per ton more than the equivalent amount of direct shipping ore. Taxpayer's other experts, Odin A. Sundness, a director of taxpayer, and Harold Cope, agreed with Professor Joseph's findings and conclusions.

(c) Taxpayer's claims for royalty income for the years 1956, 1957, and 1958 also included $18,075,917 for the premium value of the 13,556,938 tons of pellets shipped by Reserve in those years. Taxpayer's theory of recovery of such royalties was based upon the premise that it was possible for companies to realize substantial savings in their blast furnace operations through the use of taconite pellets rather than unprocessed direct shipping ores. On this account, taconite pellets sold for more in the open market than did the unprocessed direct shipping ores.

Taxpayer's claim on the premium value of the pellets was speculative in nature. In order for it to win its argument, it was necessary for taxpayer to prove that Republic and Armco experienced substantial savings as a result of their use of the pellets. In addition, taxpayer would have also had to interpret the 1939 Mesabi-Reserve lease agreement provision indicating that the price for the pellets should be based upon the "* * * market for material of like value * * * for like quantities" to recognize separate markets for taconite pellets and direct shipping ore of the same iron content. It was Reserve's contention that the only available market for arriving at a sales price was the market for direct shipping ores.

(d) While the year 1959 was not formally included in the arbitration proceedings, taxpayer did not accept Reserve's computations of net profits for 1959. These computations indicated a net profit of $1,984,406.31, one-third of which was payable to taxpayer ($661,468.77). Taxpayer's claim for additional royalty income for the year 1959 would have been based on the same issues asserted for the years 1956, 1957, and 1958. While the precise amount of this claim is not known, taxpayer has asserted that its total claim, attributable to issues other than the pricing of the pellets, would have been approximately $1,500,000. In addition, 3,968,463 tons of pellets were shipped by Reserve in 1959.

**30.** According to the testimony of Jesse Climenko, a partner in the firm of Gallop, Climenko & Gould, counsel to Mesabi, as of early 1960, Mesabi's litigation objectives were to divest Reserve of its stock ownership in Mesabi, to end the arbitration, and to get a fixed royalty per ton rather than the ⅓ net profit figure.

**31.** In early February 1960, the managements of taxpayer and Reserve reached agreement as to what they considered to be a sound basis for settlement of all the issues between them. As part of the settlement, Reserve was to transfer the shares of Mesabi stock it owned to taxpayer. Taxpayer saw the settlements as a means of terminating Reserve's ability to affect taxpayer's corporate decision-making process by means of voting the 12.34 percent stock interest which Reserve held in taxpayer.

**32.** On February 18, 1960, representatives of both taxpayer and Reserve prepared and agreed upon a draft designed to effectuate such Settlement Agreement. This agreement was prepared by counsel for taxpayer and Reserve and was thereupon presented to the boards of directors of both companies on February 19, 1960. Counsel for both companies recommended its adoption.

**33.** At a special meeting of taxpayer's board of directors held on February 19, 1960, the recommended basis for settlement of the controversies reached between the managements of taxpayer and Reserve was discussed and unanimously approved. Taxpayer's president was authorized to settle all issues between taxpayer and Reserve and to execute any agreements or other instruments embodying the provisions of the proposed settlement subject, however, to the provision that all such agreements or instruments would have to be approved by the many Mesabi stockholders.

The two stockholders and directors of Reserve also considered and approved the proposed settlement on February 19, 1960.

**34.** The pertinent corporate resolutions adopted at the February 19 meeting were as follows:

> RESOLVED, that the President of Mesabi be and he hereby is authorized and empowered to settle and resolve all issues raised between Mesabi and Reserve in the pending litigation and arbitration upon substantially the following terms and the terms set forth in these resolutions:
>
> Reserve is to assume all unamortized pre-production expenses which hitherto have been charged to Mesabi on the basis of a thirteen-year amortization period commencing January 1, 1957, and Mesabi is to receive the sum of $400,000 in cash. Reserve is to have no further obligation to Mesabi with respect to taconite products produced and sold to 1960. Commencing January 1, 1960 Reserve's agreement to pay Mesabi 33⅓% of the net profits is to be deleted and in place thereof Reserve will agree to pay to Mesabi a base royalty of $1 per ton of taconite product based upon an iron content of 61%

iron natural, which is produced from the Peters Lease Lands and the Cloquet and Mesabi Lease Lands which is produced and shipped by Reserve on or after January 1, 1960. * * *

* * * * *

RESOLVED, that the 163,570 shares of capital stock of Mesabi which Reserve owns and with respect to which Reserve is to transfer all of its right, title and interest to Mesabi subject only to the sequestration orders affecting said shares, be accepted and received by Mesabi; and it was further

RESOLVED, that the lawsuit filed by Mesabi in the Delaware Court of Chancery in Wilminton against Reserve seeking to recover said shares of capital stock be dismissed with prejudice as to Reserve in a manner satisfactory to Reserve; and it was further

RESOLVED, that steps satsifactory to Reserve be taken for the dismissal with prejudice of all other actions or counterclaims of Mesabi, including the action brought by stockholders of Mesabi in the Delaware Chancery Court, against Reserve and each of its stockholders, Republic Steel Corporation and Armco Steel Corporation, that steps satisfactory to Mesabi be taken for dismissal with prejudice of Reserve's action against Mesabi in the United States District Court at Duluth, and that the arbitration proceedings between Reserve and Mesabi be terminated; and it was further

RESOLVED, that all further proceedings in the arbitration and in all pending litigation be suspended pending the consummation of the proposed settlement; and it was further

RESOLVED: that the President of Mesabi be and he hereby is authorized and empowered to execute, acknowledge and deliver on behalf of Mesabi any agreements or other instruments in form to be approved by general counsel for Mesabi embodying the provisions of the proposed settlement substantially as outlined above, with such changes therein or additions thereto as the President in his discretion may determine, subject, however, to the provisions to be contained in any said agreements or instruments that the same shall be subject to the approval of the stockholders of Mesabi as hereinafter set forth; and it was further

RESOLVED, that a special meeting of the holders of the capital stock of Mesabi be called for April 15, 1960, or on such other date as may be fixed by the President, and at such time and place as shall be determined by the President, to consider and act upon the agreements entered into between Mesabi and Reserve embodying the settlement, and that the affirmative vote of a majority of all of the outstanding shares of capital stock of Mesabi (excluding from such majority the shares of capital stock owned by Reserve) to be required for the approval of said agreements; and it was further

RESOLVED, that the close of business on March 17, 1960 or such other date as may be fixed by the President be and hereby is fixed as the record date for stockholders entitled to receive notice of and to vote at the special meeting of stockholders to be held April 15, 1960 to consider and act upon the said settlement agreements; and it was further

RESOLVED, that Arnold Hoffman, Quincy A. Shaw, Jr. and Gilbert M. Haas be and they hereby are designated as proxies for Mesabi to vote any proxies received by Mesabi; and it was further

RESOLVED, that the proper officers of the corporation together with counsel are hereby authorized and empowered to prepare a proxy statement and such other material as may be necessary or desirable in connection with the solicitation of proxies, to file the same with the Securities and Exchange Commission, and thereafter to take such further action as may be necessary or desirable in connection with the distribution of said proxy material to the stockholders of Mesabi, and it was further

RESOLVED, that upon the approval of the said agreements by a majority of the outstanding capital stock of Mesabi (excluding from such majority the shares of stock owned by Reserve) the President be and hereby is authorized and empowered to execute, acknowledge and deliver such agreements, instruments or other documents which may be necessary or desirable in the opinion of general counsel of Mesabi to implement the provisions of the settlement agreements or to carry out the purposes of the settlement and of these resolutions, said agreements, instruments and documents to contain substantially the terms set forth in these resolutions with such changes therein or additions thereto as the President in his discretion shall determine.

**35.** In the course of considering the settlement proposal on February 19, 1960, taxpayer's board of directors discussed the terms of the settlement among themselves and with Lester J. Tanner, a partner in the law firm of Gallop, Climenko & Gould. Mr. Tanner advised the directors that $7,000,000 was the maximum amount that reasonably could be expected for taxpayer's pre-1960 claims and therefore a payment by Reserve of $7,000,000 (the 163,700 shares of Mesabi stock at $40⅜ per share plus $100,000) was essentially a complete victory on the complicated accounting claims then in arbitration.

36. Mr. Tanner also explained to taxpayer's board of directors that he believed that as a result of the settlement the maximum amount subject to taxes would be $7,000,000 of ordinary income (163,570 shares of Mesabi stock at 40 plus $400,000). Mr. Tanner testified that the figure of $40 per share was used since the tax estimate was prepared after the close of trading on February 18, 1960, on which date the Mesabi stock closed at 40⅜. Mr. Tanner speculated to the directors that argument could be made that the receipt of shares constituted a redemption or a sale of a capital asset, but that such argument would probably not be successful since Reserve was insisting that the settlement payment relate to taxpayer's pre-1960 net profits claim against Reserve. The settlement proceeds, consequently, were most likely to be treated as ordinary income.

37. On February 20, 1960, taxpayer announced publicly the terms of the Settlement Agreement and stated that the company would receive 163,570 shares from Reserve "reducing Mesabi's outstanding stock from 1,325,389 to 1,161,930 shares, or a reduction of 12.3402%." The Settlement Agreement was reported by the press on February 22 and 23, 1960. The press also reported one month later, on March 22 and 23, that taxpayer was considering a plan aimed at avoiding double taxation of its shareholders. Various brokerage houses had previously reported favorably concerning the settlement and the possible elimination of income tax at the corporate level by taxpayer. On April 7, 1960, Reserve issued a public announcement indicating that it planned to greatly expand its annual production. Such an expansion had been rumored from the date of the Settlement Agreement. As a result of these activities, numerous brokerage houses recommended the Mesabi stock as a good investment. Emphasis was given in these reports to the favorable royalty payments, the possible change from the corporate structure to eliminate corporate

income tax, the estimates of iron ore reserves, and Reserve's intention to expand production.

38. The formal settlement agreement dated February 19, 1960, was signed by taxpayer's president on February 28, 1960, and by Reserve's president on March 2, 1960.

39. Relevant portions of the Settlement Agreement are as follows:

> "2. Subject to the conditions hereof Reserve shall, at the Closing, (a) pay to Mesabi $400,000, and (b) assign to Mesabi all of Reserve's right, title and interest in all of the shares of common stock of Mesabi owned by Reserve (which Reserve represents total 163,570 shares), free and clear of all claims, liens and encumbrances, including, without limitation, the lien of the First Mortgage, dated December 1, 1952, from Reserve to Chemical Bank & Trust Company, as Trustee, so that Reserve shall have no further interest therein and with the intent that said shares of stock shall belong to Mesabi, provided, however, that said shares shall be assigned subject to any restriction of law or claim, lien or encumbrance resulting from the sequestration orders of and proceedings in the Court of Chancery of the State of Delaware in and for New Castle County in the abovementioned actions there pending; and Reserve shall cooperate with Mesabi at or after the Closing to discharge any claim, lien or encumbrance resulting from said sequestration orders, provided that in such cooperation Reserve shall not be required to appear generally in said actions or incur any liability in connection therewith. Reserve shall, at the Closing, deliver Certificate No. 5242, representing 148,700 of said shares, duly endorsed in blank for transfer, and stock powers in blank covering the remaining 14,870 of said shares represented by Certificate Nos. C 52446 through C 52593 inclusive and CO 23826, which certificates are in the possession of Mesabi, with signatures guaranteed, with requisite federal and state transfer tax stamps affixed, and if requested by Mesabi, accompanied by a corporate resolution by the Board of Directors of Reserve authorizing the transfer thereof to Mesabi. In consideration of such payment and assignment, Mesabi hereby releases Reserve, effective at the Closing, from any further obligation to Mesabi with respect to payments under the Assignment and the Mesabi Lease for products produced prior to January 1, 1960, from the lands covered by the Peters Lease and other mineral bearing lands leased or assigned by Mesabi

to Reserve, whether or not such products were shipped by Reserve prior to such date.

"3. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall cause the abovementioned arbitration proceedings to be terminated.

"4. Subject to the conditions hereof, Mesabi and Reserve, at or prior to the Closing, shall (a) stipulate for the dismissal with prejudice of all pending actions or counterclaims of either of them against the other, its present and former officers, directors or stockholders, and (b) cause to be dismissed by stipulation of the necessary parties thereto, or move to dismiss, the above-mentioned *Putterman* v. *Daveler* action and take all steps reasonably necessary to secure a prompt dismissal of such action.

"5. Subject to the conditions hereof, effective at the Closing, each party hereby releases the other party, its present and former officers, directors and stockholders in whatever capacity, from all claims, demands, actions or causes of action of any kind or nature, other than the obligation of Reserve released by Mesabi pursuant to paragraph 2 above, asserted in the above-mentioned arbitration and actions pending in the courts and from all other claims, demands, actions or causes of action of any kind and nature which either party might have against the other party, its present and former officers, directors or stockholders in whatever capacity, or any of them, arising in any way out of any action, inaction, default or alleged default which occurred prior to the Closing, excepting, however, any right, claims, demands, actions or causes of action of any kind or nature arising out of or created by this agreement.

"6. Mesabi represents that the matters covered by this agreement have been unanimously approved by its board of directors and that such board will recommend approval and authorization of this agreement by Mesabi's stockholders. Mesabi shall submit this agreement to its stockholders for approval and authorization, with such recommendation of its board of directors, at a meeting to be held not later than April 22, 1960, and will use its best efforts to obtain the highest possible number of shares to be voted at such meeting or any adjournment or adjournments thereof, but such adjournment or adjournments may not be to a date later than May 31, 1960, or such later date as Reserve may approve in writing. Reserve represents that its execution of this agreement has been duly authorized by its board of directors and its stockholders.

"7. Proceedings by Mesabi, Reserve, Republic and Armco in the above-mentioned arbitration and actions pending in the courts and payment of any sums which, except for this agreement, would be payable by Reserve to Mesabi under the Assignment or the Mesabi Lease, shall be suspended during the period from the date hereof until the action by Mesabi's stockholders at the meeting referred to above, and until the Closing if the stockholders vote for approval as hereinafter specified. After the Closing Reserve shall have no obligation to pay the sums so suspended.

"8. Performance of the obligations of Mesabi and Reserve set forth in paragraphs 1 through 5 above are subject to the conditions that approval and authorization shall have been given by the affirmative vote of a majority of all the outstanding shares of Mesabi, excluding from such majority the shares owned by Reserve.

"9. The Closing shall be held on the fifth business day following the close of the meeting of Mesabi's stockholders approving and authorizing the matters covered by this agreement as hereinbefore provided at the office of Republic, Republic Building, Cleveland, Ohio, or at such other time and place as Mesabi and Reserve shall theretofore mutually agree. If the Closing is not held, this agreement shall become null and void and shall be without prejudice to Mesabi, Reserve, Armco and Republic, and their respective present and former officers, directors and stockholders."

**40.** On March 4, 1960, taxpayer's board of directors held a special meeting at which it was decided that the Annual Meeting of its stockholders, scheduled for April 15, 1960, would be deferred until April 22, 1960, so that a joint annual and special meeting of stockholders could be held for the purpose of electing directors and acting upon the Settlement Agreement. As of the record date for the vote, March 18, 1960, Mesabi had over 2700 individual and 250 institutional shareholders. No individual directly owned more than 37,154 shares, and most individuals held fewer than 100 shares.

**41.** The express condition of the Settlement Agreement requiring that it be approved and authorized by the affirmative vote of a majority of the outstanding shares of taxpayer, excluding from the majority the shares owned by Reserve, was a condition insisted upon by Reserve and was in accordance with taxpayer's previously established policy of obtaining stockholder approval for any substantial modification of the Mesabi-Reserve contractual relationship. All documents pertaining to the settlement expressly recognized and provided that the proposed settlement was subject to the condition that it be approved and authorized by the affirmative vote of a majority of the outstanding shares of taxpayer, excluding the shares owned by Reserve.

**42.** On March 21, 1960, taxpayer mailed to its stockholders a *Notice of Joint Annual and Special Meeting of Stockholders*, a proxy statement (dated March 18), and a proxy, and taxpayer's annual report for 1959. The proxy statement stated in part that the settlement would be consummated on the fifth business day following the close of the meeting of taxpayer's stockholders, if the settlement was approved by the stockholders. The proxy statement also indicated that the affirmative vote of a majority of all the outstanding shares of taxpayer, excluding the shares owned by Reserve, was required for approval and authorization of the settlement agreement. The proxy statement, however, (1) did not indicate that the $400,000 in cash and Mesabi stock were to be received in settlement of only taxpayer's claims for royalty income, and that taxpayer was to receive no consideration from Reserve, Republic, and Armco for dismissing its antitrust claims; (2) did not set forth the value of taxpayer's claims for royalty income which taxpayer's board of directors or legal counsel may have placed on such claims; and (3) did not refer to the market price of Mesabi stock on February 18 or 19, 1960, or at any other time.

**43.** On April 22, 1960, the meeting of taxpayer's shareholders was held and the proposed settlement was approved by a vote of 1,016,049 to 970 shares, the shares owned by Reserve not being voted. The resolution of taxpayer's stockholders provided as follows:

> RESOLVED, that the settlement agreement dated February 19, 1960, between MESABI IRON COMPANY and RESERVE MINING COMPANY be and it is hereby approved and authorized, and the execution thereof by the president of MESABI IRON COMPANY on behalf of said corporation is hereby approved, ratified and confirmed in all respects.

Taxpayer's management never advised the stockholders that in their (the stockholders') consideration of the proposed settlement they were to consider the value of the 163,570 shares of Mesabi stock to be only $40. Thus, in evaluating the proposed settlement taxpayer's stockholders realistically could have taken into consideration the market price of Mesabi stock on the date they mailed in their proxies (taxpayer's proxy statement was mailed to the Mesabi shareholders on March 21, 1960) or on April 22, 1960, the date of the shareholder vote approving the Settlement Agreement. In either case, the shareholders would have considered a market value considerably higher than on February 19, 1960, the date of the agreement.

**44.** On April 25, 1960, the court in *Putterman* v. *Daveler* (Del. Ct. Chan.), upon motion of the plaintiffs and also taxpayer, ordered the action dismissed with prejudice and all shares of Mesabi stock owned by Reserve released from the seizure and sequestration. On April 25, 1960, the court in *Mesabi Iron Co.* v. *Republic Steel Corp. and Armco Steel Corp.* (D. Del.), pursuant to the stipulation of the parties, ordered the case dismissed with prejudice. Also on April 25, 1960, the court in *Mesabi Iron Co.* v. *Raymond Hindle and Reserve Mining Co.* (Del. Ct. Chan.), upon motion of taxpayer, ordered the case dismissed as to Reserve with prejudice and all shares of Mesabi stock owned by Reserve released from the sequestration order. On April 27, 1960, the parties in *Reserve Mining Co.* v. *Mesabi Iron Co.* (D. Minn.) entered into a stipulation of dismissal of the action.

**45.** On April 27, 1960, Reserve transferred to taxpayer, in accordance with the terms of the settlement, the 163,570 shares of Mesabi stock, a check in the amount of $400,000, and a check in the amount of $1,464,960.85 representing a straight royalty payment based upon production during the first quarter of 1960. The 163,570 shares of Mesabi stock were transferred by Reserve free and clear of any claim, lien, or encumbrance, since on April 25, 1960, such shares of stock had been released from the sequestration orders.

**46.** No provision of the Settlement Agreement required that taxpayer retire the 163,570 shares of Mesabi stock previously held by Reserve. Taxpayer, however, decided voluntarily to hold the shares of stock it received from Reserve as treasury stock. Taxpayer's management advised the Mesabi shareholders in Interim Report No. 18 issued February 20, 1960, and in a proxy statement required by the Securities and Exchange Commission and filed on March 18, 1960, that the net effect of the settlement would be to reduce taxpayer's outstanding stock by 12.3 percent. Despite disclosing the aforementioned course of action, taxpayer's management made no commitment to refrain from releasing the stock for sale at a future date.

**47.** On November 11, 1960, over the objection of then director Gilbert Haas that cash was required to meet Mesabi's tax obligations, the corporation issued a cash dividend of $3.00 per share or a total of $3,579,672.

**48.** On April 6, 1961, taxpayer distributed to its stockholders rights to buy 119,322 shares of stock at $60 per share. The proceeds of the offering, estimated at $7,100,000 after expenses, were to be used as a reserve against possible 1960 tax liability in excess of that conceded by the company and declared on its 1960 return.

**49.** The number of shares traded in the common stock of Mesabi on the American Stock Exchange, and the closing price, each day for the period of February 1, 1960, through May 2, 1960, was as follows:

| *1960* | *Volume* | *Closing Price* |
|---|---|---|
| Feb. 1 | 300 | 35¼ |
| 2 | 300 | 35½ |
| 3 | 1,600 | 36 |
| 4 | 700 | 35 |
| 5 | 500 | 35½ |
| 8 | 2,300 | 35¼ |
| 9 | 500 | 35¼ |
| 10 | 500 | 35⅛ |
| 11 | 300 | 35 |
| 12 | 4,300 | 35⅞ |
| 15 | 4,000 | 35¾ |
| 16 | 6,500 | 39 |
| 17 | 5,900 | 39 |
| 18 | 5,300 | 40⅜ |
| 19 | 22,700 | 45 |
| 23 | 43,700 | 52¾ |
| 24 | 10,500 | 51 |
| 25 | 17,400 | 50⅛ |
| 26 | 6,600 | 53⅜ |
| 29 | 11,200 | 54½ |

| 1960 | Volume | Closing Price |
|---|---|---|
| Mar. 1 | 18, 400 | 58¼ |
| 2 | 13, 500 | 60⅞ |
| 3 | 8, 400 | 56½ |
| 4 | 10, 500 | 58¾ |
| 7 | 4, 100 | 58⅞ |
| 8 | 6, 700 | 56¾ |
| 9 | 3, 300 | 58¼ |
| 10 | 2, 100 | 57 |
| 11 | 4, 900 | 57¾ |
| 14 | 3, 300 | 58¾ |
| 15 | 15, 200 | 63¾ |
| 16 | 14, 300 | 67⅜ |
| 17 | 7, 800 | 65¾ |
| 18 | 5, 000 | 69¼ |
| 21 | 6, 500 | 70¾ |
| 22 | 15, 800 | 74¾ |
| 23 | 9, 200 | 72 |
| 24 | 4, 700 | 72⅞ |
| 25 | 4, 400 | 68½ |
| 28 | 5, 700 | 69⅛ |
| 29 | 1, 300 | 69¼ |
| 30 | 5, 500 | 72¼ |
| 31 | 2, 100 | 71 |
| Apr. 1 | 2, 000 | 71½ |
| 4 | 2, 600 | 73 |
| 5 | 2, 200 | 72 |
| 6 | 5, 200 | 74¼ |
| 7 | 10, 600 | 75 |
| 8 | 3, 000 | 75 |
| 11 | 2, 600 | 74 |
| 12 | 1, 400 | 74⅝ |
| 13 | 5, 400 | 78½ |
| 14 | 6, 900 | 80⅝ |
| 18 | 2, 800 | 80 |
| 19 | 4, 200 | 78½ |
| 20 | 1, 900 | 79 |
| 21 | 4, 200 | 82¾ |
| 22 | 9, 600 | 75½ |
| 25 | 5, 400 | 73½ |
| 26 | 1, 800 | 74¼ |
| 27 | 3, 100 | 71⅝ |
| 28 | 3, 100 | 71¾ |
| 29 | 4, 500 | 73½ |
| May 2 | 2, 400 | 74¾ |

**50.** During 1960, Mesabi traded at a high of 92 and a low of 34¼. From January 2, 1961 through March 30, 1961, the stock traded at a high of 127 and a low of 81½. On March 30, 1961, the high was 127 and the low 118.

**51.** The mean prices, i.e., the average of the high and low prices, of Mesabi's common stock on February 18, and 19 and April 22, 1960, were as follows:

| | |
|---|---|
| February 18 | $39. 9375 |
| February 19 | 43. 1875 |
| April 22 | 78. 25 |

52. Taxpayer recognized the income from the settlement in its 1960 income tax return, prepared according to accrual accounting principles. Taxpayer reported taxable income of $7,388,676.66, which included gross income in the amount of $7,066,042.20 designated as "Royalty-Additional Income From Settlement of Prior Years Claims." Upon audit of the return, the Internal Revenue Service (IRS) increased the royalty income so reported by $7,717,232.60 solely because of the determination that the market value of the 163,570 shares of Mesabi stock was in excess of that reported by taxpayer. In preparing its return, taxpayer used the price of Mesabi stock at the close of the market on February 18, 1960, that being the price considered by taxpayer's board of directors at their February 19, 1960 meeting. Taxpayer also included a downward adjustment of 4¼ dollars per share for "blockage" based upon an opinion from Kuhn, Loeb & Company. In issuing its adjustment, the IRS used a price of 78¼. That value represented the mean price, i.e., the average of the high and low selling prices, of taxpayer's capital stock on the American Stock Exchange on April 22, 1960.

Consistent with its determination that taxpayer realized additional royalty income, the service allowed taxpayer additional deductions for depletion in the amount of $1,159,584.89 and for royalty taxes in the amount of $826,846.35.

53. As a result of the adjustments made to taxpayer's 1960 income tax returns by the IRS, additional income taxes in the amount of $3,016,132.64, plus interest of $239,596.61 were timely assessed against taxpayer. These additional charges were paid in full on November 30, 1962, by the Mesabi Trust, transferee of all the assets of taypayer. Subsequently, the IRS timely assessed an additional interest charge with respect to income taxes for 1960 in the amount of $65,983.07, which amount was paid in full on April 2, 1963, by the Mesabi Trust.

54. The Agreement of Trust between Mesabi and Bankers Trust Company and the other named trustees was entered into pursuant to the provisions of a plan of complete liquidation of Mesabi Iron Company, duly approved by the board of directors of the company on May 26, 1961, and

duly adopted by the stockholders of Mesabi on June 23, 1961. Said plan of complete liquidation provided, among other things, for the transfer by Mesabi of its assets to the Mesabi Trust and Land Trust and for the distribution to the stockholders of Mesabi, in exchange for their shares of the capital stock of Mesabi, of Trust Certificates evidencing beneficial interest in the Mesabi Trust and Land Trust. Section 1.4 of the Agreement of Trust provides that in the event a liability is asserted against the trustees as transferees of the Trust Estate on account of any liability of Mesabi, the trustees may use that portion of the Trust Estate necessary to contest and pay the liability.

55. A Certificate of Dissolution of the Mesabi Iron Company was filed in the Office of the Secretary of State of the State of Delaware on July 31, 1961.

56. The Mesabi Trust, transferee of the assets of taxpayer, paid the resulting tax deficiency, filed claims for refund which, to the extent they relate to the issues here, were rejected, and this suit followed.

57. The parties agree that in the event it is determined that taxpayer as a result of its receipt of the 163,570 shares of Mesabi stock realized income in an amount less than $14,335,274.80, the deduction for depletion and royalty taxes claimed by taxpayer on its return for 1960 and those allowed by the IRS upon audit must be correspondingly reduced.

### CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

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## RICHARD M. DOGGETT v. THE UNITED STATES

**[No. 459-73. Decided July 11, 1975. Plaintiff's motion for rehearing and reconsideration to alter or amend judgment denied October 3, 1975.]**

### ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Military pay; withdrawal of "field advancement"; agency discretion.—Plaintiff, currently serving as a Navy postal clerk, first class,**

seeks, *inter alia*, promotion to the grade of chief postal clerk, effective May 1, 1970 and retroactive pay of that grade. Plaintiff, while serving in Vietnam, was recommended for a "field advancement" by his commanding officer who shortly thereafter and before the recommendation was acted upon, withdrew the recommendation, assigning as a reason that plaintiff was under investigation for alleged black market activities. Plaintiff was found not guilty by a court-martial, and had already been ordered transferred to another duty station where "field advancement" was not authorized. Plaintiff's request to the Board for Correction of Naval Records to have his records corrected to reflect the recommended promotion was denied. During proceedings in this court, the commanding officer averred by affidavit that the withdrawal was also due to information revealed during the investigation that plaintiff was not performing his duties as well as supposed. Under the circumstances here, the court declines to interject itself into the discretionary military promotion process. It is *held* (1) that plaintiff did not have a clear-cut legal entitlement to the pay of the higher grade; (2) that prejudice to plaintiff because of the absence of notice of withdrawal of the recommendation is speculative at most and the error is insufficient to nullify the withdrawal; and (3) that the Board's refusal to hear plaintiff's case was not arbitrary or capricious. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Military pay; promotions; courts, jurisdiction.**

[1] This court will not interject itself into the discretionary military promotion process even if legal error was in some respect committed as to the complaining serviceman, and while normally the court will not award a person pay above the pay of the position he actually occupied, it will do so if he shows a clear-cut legal entitlement to the pay of a higher rank.

Armed Services 🔑 23.5

**Military pay; promotions; administrative discretion.**

[2] The power of a commanding officer to recommend a promotion of a serviceman implies a power to withdraw the recommendation at any time before it is acted upon.

Armed Services 🔑 21

**Military pay; promotions; withdrawal of promotion.**

[3] In determining whether a commanding officer was arbitrary and capricious in withdrawing his recommendation of plaintiff's promotion rather than suspending the promotion pending results of an investigation of plaintiff's alleged black market activities, the subsequent acquittal of plaintiff does not require the court to pretend that the investigation was never made, if the fruits of the investigation are used only for different purposes than prosecution or other adverse action of a punitive kind, such as where the investigation revealed that plaintiff was deficient in job performance.

Armed Services 🔑 21

**Military pay; promotions; withdrawal of promotion; notice, failure to give.**

[4] Where plaintiff was under investigation for alleged black market activities, the fact that he was not furnished with notice of withdrawal of a previous recommendation for promotion does not constitute error sufficient to nullify the withdrawal since he could hardly have expected to be promoted until the matter was resolved. Even if the withdrawal were nullified, since the recommendation was never acted upon it was never converted into a legal right.

Armed Services ⚿ 21

**Military pay; administrative discretion; generally.**

[5] The military correction boards, within reasonable limits, enjoy discretion as to what injustices are grave enough to call for action by it.

Armed Services ⚿ 21

*Donald D. Chapman*, attorney of record for plaintiff.

*John W. Showalter*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before DURFEE, *Senior Judge*, NICHOLS, and KASHIWA, *Judges*.

NICHOLS, *Judge*, delivered the opinion of the court:

This simple case could be disposed of by order instead of signed opinion except that it involves the important question of whether plaintiff has a clear-cut legal entitlement to the pay of an office to which he claims he should have been promoted. The case is before us on cross motions for summary judgment and there is no issue as to any relevant fact. We conclude that the promotion remained discretionary and the plaintiff cannot recover. In discussing plaintiff's contentions to the extent we do, we assume *arguendo* that our jurisdiction extends that far.

The plaintiff was and is a Postal Clerk, First Class, in the United States Navy, a petty officer grade. From June 16, 1969 to May 7, 1970, he served in Vietnam. By special rule applicable in that theatre, if he met certain qualifications, which he did meet, he could be promoted on recommendation of his commanding officer, without regard to restrictions applicable to those serving elsewhere. This was called a "field advancement." On February 10, 1970, his commanding officer, Captain W. J. Diffley, recommended that he be promoted to Chief Petty Officer, but on March 27, 1970, withdrew the recommendation, assigning as a reason that plaintiff was under investigation for "money manipulation", *i.e.*, black market activities. Captain Diffley himself had requested this investigation at some unstated date, and plaintiff learned of its pendency before February 10, to wit on February 7, when he sought orders to leave Vietnam. The withdrawal was not made known to plaintiff at the time, and under date of April 10, 1970, plaintiff's name was published by the Bureau of Naval Personnel among persons "who were authorized advancement to chief petty officer". Plaintiff had a court-martial commencing on May 2, and on May 9, 1970, he was found not guilty on all charges. Plaintiff had already been ordered transferred to another duty station where "field advancement" was not authorized. Captain Diffley was also transferred out before the investigation was complete. After arriving in the United States plaintiff communicated with him but he declined to recommend reinstatement, believing it would be improper to do so. The next commanding officer in Vietnam did not know the quality of plaintiff's work and could not be expected to reinstate the nomination. Captain Diffley now says by affidavit that the withdrawal was not predicated solely on the fact plaintiff was facing a court-martial, but was also due to matter that surfaced in the investigation, indicating that plaintiff was not performing his duties quite as well as supposed.

It is undisputed that Captain Diffley could have merely suspended the promotion until the investigation was finished and the outcome was known.

Since plaintiff left Vietnam he has encountered various obstacles to promotion, the propriety of which he does not deny. He says that withdrawal of Captain Diffley's recommendation without notice to him was a denial of due process and constituted arbitrary and capricious action.

The Chief of Naval Personnel on August 10, 1970, denied plaintiff's request to be promoted on the Diffley recommendation. The plaintiff has also applied to the Board For Correction of Naval Records, which denied the application without a hearing, holding that plaintiff had presented insufficient evidence to indicate probable material error or injustice.

Plaintiff is still in active service at his old grade. It will be apparent that the only pecuniary relief we could grant would necessarily require a constructive promotion to plaintiff as of some past date, with back pay based thereon. We have repeatedly refused to interject ourselves into the discretionary military promotion process even if legal error was in some respect committed as to the complaining serviceman. *Abruzzo* v. *United States*, 206 Ct. Cl. 731, 513 F. 2d 608 (1975); *Yee* v. *United States*, 206 Ct. Cl. 388, 512 F. 2d 1383 (1975); *Cooper* v. *United States*, 203 Ct. Cl. 300 (1973); *Clinton* v. *United States*, 191 Ct. Cl. 604, 423 F. 2d 1367 (1970). While normally we will not award a person pay above the pay of the position he actually occupies we do so if he shows a clearcut legal entitlement to the pay of a higher grade. *Selman* v. *United States*, 204 Ct. Cl. 675, 684, 498 F. 2d 1354, 1358 (1974). The question is, therefore, whether plaintiff had a clearcut legal entitlement to pay of the grade above the one he was in, from the time his commanding officer recommended his promotion, other qualification requirements having been satisfied previously.

The answer is clearly no. We believe that in the absence of any contrary requirement, a power such as Captain Diffley had, to recommend a promotion, implies a power to withdraw the recommendation at any time before it is acted on. *D'Arco* v. *United States*, 194 Ct. Cl. 811, 441 F. 2d 1173 (1971). The April 10, notice by the Bureau of Naval Personnel does not say the promotions of the persons listed are in effect. Rather it calls on commanding officers to advise the Bureau if any of the persons named are ineligible. Plaintiff's promotion therefore remained discretionary until the recommendation was acted on, which it never was.

Answers to the other issues fall readily into place after this. The plaintiff says Captain Diffley was arbitrary and capricious in withdrawing his recommendation when he could have merely suspended the promotion, pending the results of investigation. His own imminent departure from

Vietnam furnished a rational reason why he would not wish to leave his promotion recommendation hanging in the air. As he says himself, the first fruits of the investigation threw new light on the plaintiff's job performance. The acquittal does not require the court to pretend that the investigation was never made, if used only for different purposes than prosecution or other adverse action of a punitive kind.

Defendant admits the absence of notice of withdrawal was procedural error, as plaintiff should have been shown the withdrawal and required to sign it as his admission of notice. Defendant says the error was not prejudicial. We note plaintiff knew he was under investigation. He had orders to another duty station the whole time it was under way, and he was held in Vietnam solely because of it. He hardly could have expected to be promoted until the matter was resolved. In the circumstance, the prejudice is speculative at most and the error insufficient to nullify the withdrawal itself, but if it were nullified, we would still have a recommendation never acted on so as to convert it into a legal right.

Nor do we think plaintiff shows enough to establish that the Board refusal to hear his case was arbitrary or capricious. The chance for a "field advancement" was fleeting at best, and the loss of it without the enlisted man's own fault may well have been too common to rectify through Correction Board procedures which manifestly are intended for more aggravated instances of error or injustice. The Board could have held that the loss of the promotion though not "error" in the legal sense, was "injustice". We have held, as in *Skaradowski* v. *United States*, 200 Ct. Cl. 488, 471 F. 2d 627 (1973), that some injustices are so flagrant as to demand relief even in the absence of legal error, so that the refusal of it is arbitrary and capricious. The Board, within reasonable limits, enjoys discretion not subject to second guessing by us, as to what "injustices" are grave enough to call for action by it. *Cooper*, *supra*. Here it has not abused that discretion, in our view.

Accordingly the plaintiff's motion for summary judgment is denied, the defendant's motion for summary judgment is granted, and the petition is dismissed.

Syllabus

# JAMES A. MICHIENZI v. THE UNITED STATES

[No. 108–74. Decided July 11, 1975]*

ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Military pay; correction of military records; promotion.**—Plaintiff, a Lieutenant Colonel in the Army of the United States and a Major in the Regular Army, voluntarily retired on May 31, 1973. On November 6, 1970 plaintiff was detained by security personnel on suspicion of having committed a criminal offense; on November 17, 1970 he was recommended for promotion to Lieutenant Colonel, Regular Army; on November 19, 1970 disciplinary processing was ordered. Plaintiff refused non-judicial punishment and insisted upon a court-martial; however, in view of subsequent psychiatric evidence the convening authority dismissed all charges. The Commanding General, Strike Command urged that plaintiff's usefulness was greatly diminished and recommended removal of his name from the promotion list and non-consideration for Senior Service Schooling. The Department of Army Suitability Evaluation Board (DASEB) concluded that the adverse suitability information cast doubt upon plaintiff's suitability and reliability as an officer, that it had the right to consider the investigation report of the incident and the psychiatric evaluations, subject to plaintiff's right of contradiction, that plaintiff had not satisfactorily explained or refuted the information, and it recommended incorporation of the material in plaintiff's file for future selection boards. On application to the Board for Correction of Military Records (BCMR), plaintiff demanded removal from his records of all documents relating to the incident, but did not request retroactive promotion or vacating of any selection board action; the Board denied him a hearing and held that he had failed to show error or injustice. His application for voluntary retirement occurred before the BCMR had completed its consideration of the case, although plaintiff was not then scheduled for mandatory retirement. Plaintiff here seeks retroactive promotion, expungement from his records of the adverse suitability information, and a declaration that the regulations governing the DASEB and BCMR are constitutionally inadequate. For the reasons set forth, it is *held* that the authorities were warranted in continuing the "flagging" of plaintiff's file; that the BCMR did not abuse its discretion in not effecting correction of his records and granting him retroactive promotion since he failed to put the board sufficiently on notice that he wanted a retroactive promotion; that he was not legally entitled to promotion; that in view of his voluntary retirement he has failed to show the refusal to

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*Plaintiff's motion for rehearing *en banc* was denied October 3, 1975; opinion was amended as reflected in this report and as indicated in the Order of October 3, 1975 quoted *in toto post* at 1033.

correct his records for prospective personnel action caused him pecuniary injury; and that since monetary relief is not available, it is without this court's power to grant the other relief requested. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.

**Military pay; promotions; flagging actions.**

[1] Under Army regulations, a "flagged" officer's name goes before selection boards for consideration for promotion, but the board is not informed of the "flag." Although criminal charges against plaintiff were dismissed, in view of the psychiatric evidence that, *inter alia*, in a neurotic sense he was not so free of mental defect, disease or derangement as to be able, concerning the particular act charged, to adhere to the right, continued "flagging" was warranted to determination of plaintiff's suitability for promotion under AR 640–98 and Memorandum 600–10.

Armed Services 🔑 7

**Military pay; promotions; administrative discretion.**

[2] The power of a commanding officer to recommend a promotion of a serviceman implies a power to withdraw the recommendation at any time before it is acted upon and before the expectations of promotion become a legally protected right. *Doggett* v. *United States*, *ante at* 478.

Armed Services 🔑 7

**Pleading and practice; implementation of judgments; correction of applicable records.**

[3] Pub. L. 92–415 does not authorize this court to correct an administrative record except as an incident to a pecuniary remedy, for instance where plaintiff, in view of his voluntary retirement prior to mandatory retirement, has failed to show that the administrative refusal to correct his records for prospective personnel action caused him monetary injury.

Armed Services 🔑 13.6(1)

**Court of Claims jurisdiction; declaratory judgments; correction of military records.**

[4] Since the court has determined that a retroactive promotion of plaintiff is unavailable under the circumstances, it is outside the court's power to order expunged from plaintiff's military records the adverse suitability information originating with the Department of Army Suitability Evaluation Board for prospective personnel actions, or to declare that regulations governing said Board and the Board for Correction of Military Records are constitutionally inadequate.

Armed Services 🔑 7

*Donald D. Chapman*, attorney of record for plaintiff.

*LeRoy Southmayd, Jr.*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before DURFEE, *Senior Judge*, NICHOLS and KASHIWA, *Judges.*

NICHOLS, *Judge*, delivered the opinion of the court:

This case was argued following *Doggett* v. *United States*, *ante* at 478. The same counsel represented both plaintiffs, but counsel for defendant was different. Plaintiff's counsel thought the two cases were companion cases, and they do have some features in common. However, the differences require separate opinions. This case is before us on cross motions for summary judgment and there is no issue of relevant fact requiring trial. In discussing plaintiff's contentions to the extent we do, we assume *arguendo* that our jurisdiction extends that far.

Plaintiff was a Lieutenant Colonel in the Army of the United States and a Major in the regular Army. His record shows gallantry in combat and many decorations. His service began with enlistment on June 29, 1943, and ended with voluntary retirement on May 31, 1973. The main issue, on which others turn, is at what rank was plaintiff entitled to serve in his final two years of active duty and in what rank should he be retired, Lieutenant Colonel or Colonel? Thus the issue, as in *Doggett*, is whether plaintiff has a clear-cut legal entitlement to the higher active duty and retirement pay of the office to which he claims he should have been promoted.

On November 6, 1970, plaintiff was detained by security personnel at the Base Exchange, MacDill Air Force Base, Florida, on suspicion of shoplifting a radio valued at $35.50. On November 11, 1970, he was notified that he had been selected for attendance at the National War College and on November 17, 1970, a Department of the Army Selection Board recommended him for promotion to Lieutenant Colonel, Regular Army. On November 19, 1970, he was ordered to Fort Stewart, Georgia, for disciplinary processing. Government counsel puts an exclamation mark at this point in his recital of the above facts. He should learn not to be astounded so easily. Such juxtapositions of events occur in Government all the time and any of us with extended Government experience could cap the story.

The shoplifting incident eventually halted the favorable developments in plaintiff's career, and unfavorable ones multiplied.

The incident, after investigation, led to a proposal that plaintiff be eliminated from the Army. He refused to accept non-judicial punishment and insisted on his right to a court-martial. His counsel made it known, however, that plaintiff would enter a defense of temporary derangement based upon psychiatric reports of three civilian psychiatrists. Plaintiff was ordered to appear before a "sanity board" of four Army psychiatrists. They found that plaintiff could distinguish right from wrong, but could not control his impulses at the time of the offense, and in a neurotic sense, was not so free of mental defect, disease, or derangement, as to be able, concerning the particular act charged, to adhere to the right. They referred to pressures and conflicts from which plaintiff was suffering, which made the action comparable to a compulsive act, the motives of which were unknown to plaintiff and were therefore unconscious.

The nature of these pressures and conflicts is not stated in the record, nor is there any suggestion they were due to causes that would not be repeated, such as *e.g.*, shell shock from plaintiff's then recent Vietnam experience. However, later medical reports indicated a hopeful prognosis if plaintiff submitted to treatment.

In view of the posture of the psychiatric evidence the convening authority dismissed all charges against the plaintiff.

The Strike Command General wrote the Army Chief of Staff urging that plaintiff's usefulness was greatly diminished and that the Army could ill afford to have senior officers in important positions who could not adhere to the right. He recommended removal of plaintiff's name from the promotion list and that he be not further considered for Senior Service Schooling, *i.e.*, apparently, the War College.

The Deputy Chief of Staff referred plaintiff's case to the Department of the Army Suitability Evaluation Board (DASEB) for advice as to whether future decision makers should consider the incident in future personnel actions. This Board, after reviewing the files, got off what may best be called a blast against the plaintiff, reciting the alleged facts of the shoplifting incident as shown by the investigation, expressing profound skepticism as to the explanation of it by psychiatrists, and indicating that in any event there was no guarantee the incident would not occur again. The Board concluded that the adverse suitability information would appear to cast doubt upon plaintiff's suitability. Apparently, future personnel decision makers therefore should consider the incident.

Plaintiff had a right to respond to this report before it went before future decision makers, and his response, dated June 12, 1972 is in the record. In general he denied the right of DASEB to have or to consider either the investigation report or the psychiatric evaluations. He did not deny or offer to disprove any of the factual material the DASEB considered, simply stating generally that the summary of facts from the Art. 32 investigation was inaccurate and biased. In general, plaintiff's position then was and apparently still is that DASEB could put derogatory information before future personnel decision makers not only after notice and an opportunity to reply, which he had, but also only after an adversary due process type hearing.

The Board on receipt of this reaffirmed its right to consider the derogatory material subject to plaintiff's right to contradict it, held that plaintiff had not satisfactorily explained or refuted the information and concluded that it reflected on plaintiff's character, integrity, trustworthiness and reliability as an officer in the United States Army. It recommended that the material be incorporated in "OMPF" (whatever that is, we suppose the file that went before Selection Boards) of the subject officer. In any event, on July 18, 1972, the Adjutant General advised that this would occur.

Plaintiff applied to the Army Board For Correction of Military Records (BCMR), under date of October 24, 1972. He demanded removal from his record of all documents relating to the shoplifting incident, but that Board denied him a hearing, held he had failed to show error or injustice, and reaffirmed its position on his subsequent request for reconsideration. He did not request a constructive or retroactive promotion or the vacating of any Selection Board action, in his official application to the Board. His counsel's brief does demand promotion to Colonel "as of the date of eligibility." Endorsements on the application for voluntary retirement of January 15, 1973, which actually preceded the final BCMR refusal to reconsider, show plaintiff was not then scheduled for mandatory retirement.

This case is not like *Boyd* v. *United States*, *ante* at 1, and cases there discussed, wherein the pass over of an officer by a Selection Board cut short an active duty career, giving us an issue to consider, whether the material before the Board, and considered by it, was fair and just to the officer, or maligned him improperly. Here plaintiff remained on active duty until his wholly voluntary retirement. Counsel for plaintiff says a Board selected plaintiff for Colonel (presumably AUS) on September 4, 1970, and elsewhere it is said plaintiff's name appeared on a "recommended list" for temporary promotion to Colonel on October 23, 1970. Also, at some time after the Adjutant General's letter, *i.e.*, some time after July 18, 1972, plaintiff's name was sent to a Selection Board and on recommendation of the Board, plaintiff's name was removed from the promotion list, his counsel says. He offers no substantiation of these statements by affidavit or document and none can be found in the apparently complete administrative file. Per our Rule 101(f), they cannot be taken as true for summary judgment purposes. Defendant, however, does not deny them, and to save a possible rehearing petition we take them *arguendo* as true.

Plaintiff's name was "flagged", from the shoplifting incident to his retirement. Under Army regulations, a "flagged" officer's name goes before Selection Boards just like others, but the Board is not informed of the "flag". *Borys* v. *United States*, 201 Ct. Cl. 597, *cert. denied*, 414 U.S. 1001 (1973). No doubt plaintiff when he retired anticipated that the DASEB evaluation in his file would assure his being passed over whenever his name did go before a Selection Board, if it had not already, and if by some miracle it did not pass him over, the "flag" would still prevent his being actually promoted. The record seems to show, however, that plaintiff could have remained on active duty for a period not shown by the record in his present grade, and if he displayed sufficient improvement under psychiatric treatment, so far as appears he might have then had the barriers removed and had the promotion his previous record had so thoroughly earned him. There certainly was no indecent rush to get him out.

Plaintiff has not shown, even if his counsel's statements are evidence, that his expectations of promotion ever left the discretionary zone and became a legally protected right, as stated and defined in *Doggett*. As discussed more fully below, plaintiff failed to advise the BCMR properly in his petition to it, that he desired a retroactive promotion. We presume, in the absence of other explanation, that the Board selection of September 4, 1970, could not be acted on at once because the "date of eligibility" had not arrived. Plaintiff seems to think that date arrived on or about June 1, 1971. What legal effect a selection so far ahead of possible effectuation could have had we are not told and do not know. In view of the shoplifting incident, higher authority was warranted in "flagging" the promotion and plaintiff does not argue otherwise. He would have us hold that the "flagging" should have ended when the convening authority dismissed the criminal charges, October 28, 1971. However, a continued "flagging" was warranted in light of the proceedings that then ensued, to determine plaintiff's suitability for promotion under AR 640-98 and Memorandum 600-10. Whatever complaint plaintiff has about lack of due process in these proceedings, he does not and hardly can contend they should not have taken place at all. Therefore, the "flagging" rightly continued. The September 4, 1970, selection published October 23, 1970, we believe was only advisory. *Weiss* v. *United States*, 187 Ct. Cl. 1, 408 F. 2d 416 (1969).

The second Board mentioned by plaintiff's counsel perhaps was an "Army Standby Advisory Board" which he mentions in his BCMR petition of October 24, 1972, as one he doesn't want the derogatory information to go to. The timing of this Board's action is not given, but plaintiff was to submit a reply to it on December 12, 1972. Whatever this Board may have done is not shown to have had any effect on plaintiff's legal rights. If he was not promoted before he applied for retirement on January 15, 1973, neither had he become subject to mandatory retirement, as is ultimately the fate of passed over officers. There is nothing to show that whatever this Board did respecting plaintiff's promotion was not in exercise of a discretionary function and nothing to show that plaintiff by retiring did not forestall whatever might eventually have been done to implement whatever this Board may have recommended or may have been going to recommend.

Thus, as in *Doggett*, our analysis of the history of the case eliminates plaintiff's non-promotion as a legal "error" we could correct. As in that case, for completeness we consider the possibility remote as it may be, that plaintiff suffered an "injustice" not amounting to a legal "error", but still so flagrant the Board abused its discretion in not effecting a correction, *i.e.*, was arbitrary and capricious.

Obviously in this "injustice" area what a petitioner asks the BCMR to do is particularly crucial, for he is seeking relief a court, applied to directly, could not grant. The whole thrust of plaintiff's application to the BCMR was to clear away obstacles to future promotion. Despite the throwaway demand at the end of plaintiff's counsel's brief before the BCMR that plaintiff's record be corrected "to reflect promotion to Colonel as of the date of eligibility", there was no argument or showing why plaintiff was entitled to this, and the formal application to the Board itself, did not include it, either as originally filed or as later supplemented. We think, therefore, the plaintiff failed to put the BCMR sufficiently on notice he wanted a retroactive promotion, and therefore he cannot tell us they were arbitrary and capricious in not granting him one.

As regards the refusal to correct the record for prospective personnel actions, we think plaintiff in view of his voluntary retirement has failed to show the refusal caused him any pecuniary injury. We note, moreover, that the application for voluntary retirement came on January 15, 1973, only a month and ten days after his supplemental application to the BCMR and more than three months before the BCMR ruled on it, April 20, 1973. We think thereby plaintiff effectively mooted his BCMR application and also, therefore, any issue before us that the BCMR acted arbitrarily and capriciously.

This conclusion is fatal to plaintiff's whole case because the new statute, Pub. L. 92–415, 86 Stat. 652, amending 28 U.S.C. § 1491, does not authorize us to correct a record except as an incident to a pecuniary remedy. We could not, therefore, correct plaintiff's record in the particulars he demands, if the correction did not entitle him to money damages. By his petition, he wants a promotion retroactive to June 1, 1971, apparently the date of first eligibility, expungement from his record of the material originating with the DASEB, that he objects to, and a declaration by us that the regulations governing the DASEB and the BCMR are constitutionally inadequate. The first, the retroactive promotion, being unavailable, the other two are outside our power. *United States* v. *King*, 395 U.S. 1 (1969). In particular, any pronouncement by us as to constitutionality would be entirely inappropriate.

Accordingly, the plaintiff's motion for summary judgment is denied, the defendant's motion for summary judgment is granted, and the petition is dismissed.

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519 F. 2d 1378

# THE UNITED STATES v. THE LOWER SIOUX INDIAN COMMUNITY IN MINNESOTA, ET AL.

Appeal No. 17–74

Ind. Cl. Comm. Docket No. 363
30 Ind. Cl. Comm. 463 (1973)
33 Ind. Cl. Comm. 389 (1974)

[Decided July 11, 1975]

ON APPEAL FROM THE INDIAN CLAIMS COMMISSION

**Indian claims; appeal from Indian Claims Commission; relation back of amended pleading; res judicata; failure to plead affirmative defense.**—In 1951 the appellee-Indians filed five petitions with the Indian Claims Commission, the fifth petition (Docket 363) containing two claims, the second of which became the predecessor of the claims now in issue. Before final determination of the original claim, the Indians moved to amend their pleading by severing two claims from the second claim in Docket 363. Claim 363A, the first of the newly severed claims, named as plaintiffs the Sisseton and Wahpeton Tribes of North Dakota and claimed the taking of the Devils Lake Reservation of North Dakota by the United States through the Act of April 27, 1904. The Commission concluded that the language of the second claim of Docket 363 was broad enough to include the newly-stated claim and allowed the amended petitions over the objection of the Government that the claim was barred by limitations. Subsequently the Commission decided on the merits that the United States had recognized the title of the appellees to the Devils Lake Reservation by the Treaty of February 19, 1867, and concluded therein that there was a Fifth Amendment taking. Final judgment was entered on February 27, 1974. The Government here contends that the amendment to the original petition, Docket 363A, is barred by limitations, that appellees should not now be permitted to claim a Fifth Amendment taking after presenting the claim for so many years as a demand for an accounting, that the matter is res judicata as to the issues presented in Docket 363A on the basis of a consent judgment enforcing the settlement agreement entered into in 1967. That agreement provided for entry of judgments in all the then pending dockets except as to the general accounting claim of Docket 363. The court *holds* (1) that the original petition in Docket 363, Second Claim, gave fair and adequate notice to the Government of the transactions and occurrences that were later more specifically claimed in Docket 363A; and that the action of the Commission permitting the amended complaint was proper and it thereby had the authority to make a determination as to the merits of the claim of Docket 363A; (2) *concludes* that Docket 363, Second Claim, covered a request for relief under an accounting and for a Fifth Amendment taking; and (3) *concludes*, after scrutiny of the record and the law, that the issue of res judicata was not properly presented, litigated or adjudicated under the consent judgment following the settlement agreement. The decision of the Indian Claims Commission is affirmed.

**Indian claims; Indian Claims Commission; pleading and practice; amendment to pleadings; relation back of amendments.**

[1] An amended pleading filed in a case before the Indian Claims Commission relates back to the date of the original pleading if the general factual situation set forth in the original pleading has given the adverse party formal and reasonable notice of the claim presented in the amended pleading.

U S ⚿ 112

**Indian claims; Indian Claims Commission Act; construction and operation.**

[2] The Indian Claims Commission Act should be liberally construed to effect its remedial purpose and intent.

U S ⚿ 112

**Pleading and practice; actions and forms of actions; cause of action or claim.**

[3] The fact that an original pleading is general and not specific does not jeopardize the validity of the complaint. The purpose of

a complaint is to give fair notice of the nature and basis of the claim asserted and a general indication of the type of litigation involved. Wherever additional facts are necessary to prepare for trial, the various forms of discovery will be available to fill the void.

Pleading ⚿ 42

**Indian claims; Indian Claims Commission; appellate review by Court of Claims.**

[4] A defense neither pleaded nor proved, or in some other way demonstrated in a proper manner before the Commission, is waived on appeal to this court.

U S ⚿ 112

**Judgments; former adjudications; res judicata/collateral estoppel.**

[5] Res judicata and collateral estoppel are affirmative defenses that must be pleaded (Court of Claims Rule 37(b)). The purpose of such pleading is to give the opposing party notice of the plea of estoppel and a chance to argue, if he can, why the imposition of an estoppel would be inappropriate. In the present case, the Government not only failed to plead res judicata, but failed to include the issue in the pre-trial order, present evidence of the plea at trial, or in any manner affirmatively present the issue to the Indian Claims Commission.

Courts ⚿ 463

**Indian claims; Indian Claims Commission; appellate review by Court of Claims.**

[6] The Court of Claims on appeal from the Indian Claims Commission cannot and is without authority to review what the Commission did not decide and, contrary to procedural requirements, was not asked to decided.

U S ⚿ 112

*Bernard M. Sisson*, with whom was *Assistant Attorney General Wallace H. Johnson*, for appellant. *A. Donald Mileur*, of counsel.

*Marvin J. Sonosky*, attorney of record, for appellee. *Emerson Hopp*, of counsel.

Before COWEN, *Chief Judge;* MARKEY*, *Chief Judge;* and LARAMORE, *Senior Judge.*

LARAMORE, *Senior Judge*, delivered the opinion of the court:

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*Chief Judge of the U.S. Court of Customs and Patent Appeals, sitting by designation pursuant to 28 U.S.C. § 293(a).

On August 11, 1951, appellee filed five timely petitions with the Indian Claims Commission (hereinafter referred to as the "Commission") under the authority of the Act of August 13, 1946, 60 Stat. 1049, 25 U.S.C. § 70. The fifth of those petitions, Commission Docket No. 363, contained two claims, the second of which was to become the predecessor of the claims now in issue. Prior to a final determination of the original claim for relief, the Commission permitted the appellees to amend their pleading. After making timely and adequate objection concerning the amended pleading, and upon a final determination of the merits, the appellant initiated this review of the law, as applied by the Commission in the present case. Jurisdiction enabling this appeal was predicated upon the stated act (25 U.S.C. § 70s).

A review of the history and events leading to the instant appeal will show the posture of the case.

By the Treaty of February 19, 1867, 15 Stat. 505, the United States recognized that title to the Devils Lake Reservation in North Dakota, a reservation defined and set aside by the treaty itself, to be in the Sisseton, Wahpeton and Cut Head (Yanktonais) Bands of the Sioux or Dahcotah Nation.[1] Notwithstanding the recognized title and possession, the bands' quiet enjoyment of the reservation lands was periodically disturbed by the appellant and its agents. Between 1867 and 1890 the military occupied and possessed more than 11,000 acres of the reservation, for the purpose of establishing and maintaining the Fort Totten Military Reserve. The development on Indian lands was done without tribal consent or payment of just compensation. In 1875 an erroneous survey, performed by appellant's agents, resulted in the exclusion of approximately 64,000 acres from the western boundary of the Devils Lake Reservation. The error was revealed in later years. The Secretary of the Interior, who had made an examination of the unfortunate circumstance, was constrained to report to the Commissioner of Indian Affairs, in a letter dated August 9, 1887, that:

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[1] The term "Sioux or Dahcotah Nation" was traditionally used to describe nomadic Indians of the midwest who spoke the Sioux or Dahcotah language and who lived in contiguous areas. The Sioux or Dahcotah Nation was comprised of seven major self-governing divisions (Mdewakantons, Wahpakootas, Sissetons, Wahpetons, Yanktons, Yanktonais and Tetons). Based on geographic location, the Mdewakantons, Wahpakootas, Sissetons and Wahpetons were collectively referred to as the Sioux of the Mississippi (or Sioux of Minnesota). *See, Sisseton and Wahpeton Band of Sioux Indians* v. *United States*, 58 Ct. Cl. 302 (1923). The Yanktons, Yanktonais and Tetons were the Sioux of the Missouri. *See, Sioux Tribe* v. *United States*, 205 Ct. Cl. 148, 500 F. 2d 458 (1974). Yet, neither generic term may be conclusively presumed to include specifically those bands which are part of their definitional makeup. *Sioux Tribe* v. *United States, supra*.

> The boundary lines of the reservation have already been surveyed and established, and since that was done a large number of settlers have in good faith gone upon the lands lying west of the reservation line as established in 1875, believing them to be part of the public domain and have acquired rights thereon. In view of these facts, no change will be made in the western reservation line already established * * *.

Settlers had received patents to the land under the homestead and town-site laws. In addition, various parts of the 64,000 acres had previously been granted to North Dakota to be used for school and institutional purposes. The wrong had been done—the Gordian knot had been tied—the situation could not have been reversed. The only possible remedy, therefore, was to pay to the occupants of the Devils Lake Reservation money damages. Congress, thereupon, in the Act of March 3, 1891, 26 Stat. 989, 1010, appropriated $80,000 as compensation for the admitted taking.

Thereafter, the Indian Appropriations Act of March 3, 1901, ch. 832, 31 Stat. 1058, 1077, authorized the Secretary of the Interior to negotiate with "any Indians for the cession to the United States of portions of their respective reservations or surplus unallotted lands, * * *." Negotiated agreements would be subject to ratification by the Congress. Under the auspices of that act, a new and second agreement was concluded with the Indians of the Devils Lake Reservation. By the new agreement's terms, a major portion of the reservation would be ceded to the United States for a consideration of $345,000, while a small area would be reserved for future allotments to individual Indian families. The stated consideration was given not only on behalf of the exchange but, additionally, for settlement of any tribal claim growing out of the aforesaid erroneous survey of the western boundary, and any claim for loss of timber taken for the use of the military at Fort Totten from 1867 to 1890.

Congress never ratified the agreement. Instead, Congress passed the Act of April 27, 1904, 33 Stat. 319, which disposed of the property in question in a fashion distinct from the 1901 agreement. The 1904 Act ceded to the United States all unallotted lands of the Devils Lake Reservation, including the Fort Totten Military Reserve. The act also obligated the United States to grant the state of North Dakota certain parcels of said land for school purposes, save other parcels for the United States itself, to be given out thereafter for school, agency, church and mission purposes, and reserve other parcels for the establishment of a park to be known as Sullys Hill. The act additionally directed an allotment of land be made to each Indian on the reservation [2] and that the unallotted remainder be disposed of under the homestead laws.[3] The act directed that land which would be sold pursuant to the homestead laws would be priced at $4.25 per acre, and lands reserved for schools, churches and missions would be priced at $3.25 per acre. The President had the authority to lower the homestead acreage price if such would be requisite to selling the designated land. No provision was made in the act as to payment for the land to be used as the Sullys Hill public park. The United States was therein designated as trustee for the Indians in disposing of the land and was to pay the proceeds of the sale to the Indians.

Pursuant to the Act of August 13, 1946, *supra*, appellees filed the two-part claim in Docket No. 363.[4] Docket No. 363 was captioned "Claims Relating to Treaty of June 19, 1858, for General Accounting and Other Relief." The first claim stated therein was for the value of land reserved for appellees in the 1858 Treaty. The "Second Claim," the procedural handling of which is the subject of contention in this appeal, alleged that the United States by virtue of various treaties, statutes and administrative acts, "has been obligated to pay various sums in money and goods to the petitioners * * * and has managed and disposed of property * * * belonging to the petitioners." Further, that the said United States "sold * * * property, including lands, belonging to the petitioners in an improvident manner; * * * [h]as taken unto itself lands and other property belonging to the petitioners" and has profited along with its non-Indian citizens at the expense of the petitioners "by its management and control of petitioners' funds and property; * * *. Finally, that "[a]ll of the records of the defendant's transactions in connection with the petitioners' funds and property * * * are in the exclusive custody and control of the defendant." Wherefore, the appellees asked for a "full and complete disclosure, accounting and report [and] for such sums and the value of lands or other property which may be found by [the] Commission to be due * * * [and] [f]or such other relief as * * * may [be] deem[ed] just * * *."

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[2] The right of individual members of the tribes to land allotments stems from the Act of February 8, 1887, 24 Stat. 388, and the Act of February 28, 1891, 26 Stat. 794. *See also*, Act of March 3, 1863, 12 Stat. 819.

[3] Based on the Commission's record, we have concluded that the total acreage figure for the Devils Lake Reservation was about 182,000 acres in 1904. A total of 6,160 acres went to 61 Indians of the reservation who had not yet been allotted land as had been required by previous treaties. *See*, n. 2, *supra*.

[4] At the time of filing the claims in Docket No. 363, the appellees filed four other petitions, all of which made a claim for the value of land, and two of the four being claims for Fifth Amendment taking. Those petitions were designated in Commission Docket Nos. 359 through 362.

In June of 1967, the Government Services Administration (hereinafter referred to as "GSA") filed its report pertaining to the interests of appellees in the litigation then pending before the Commission. The report was complete except it did "not contain an accounting of all petitioners' funds as requested in the Second Claim of Document No. 363; nor does it contain statements of gratuity payments made on behalf of petitioners. A report, or reports, on these items is being prepared and will be submitted at a later date." General Services Administration, "Re: Petitions of the Lower Sioux Indian Community in Minnesota, Indian Claims Commission Nos. 359, 360, 362, and 363," at page 2.

In 1967, a settlement was reached by the parties in all the then pending dockets except for the Second Claim in Docket No. 363. Paragraph 9 of the Stipulation for Settlement and Stipulation for Entry of Final Judgment, Docket Nos. 142, 359 through 363, provided that entry of the judgments as set forth therein:

> * * * shall finally dispose of all rights, claims or demands, which the plaintiffs in those dockets * * * have asserted, or could have asserted, with respect to the subject matter of the cases and the plaintiffs in each of those dockets * * * shall be barred thereby from

> asserting any such rights, claims, or demands against the defendant in any other, or future, action or actions, except as to the general accounting claim in Docket No. 363, as identified in Paragraph No. 13 of this stipulation. [*See*, *Sisseton and Wahpeton Bands* v. *United States*, 18 Ind. Cl. Comm. 477, 480 (1967).]

Paragraph No. 13 of the Stipulation reads, in part:

> * * * the only remaining claim in Docket No. 363 will be the claim denominated "Second Claim" in the first amended petition in Docket No. 363 for an accounting and report by the defendant as to the claimants' property and funds. [*See*, *Sisseton and Wahpeton Bands*, *supra* at 481.]

Final proceedings concerning Docket No. 363, Second Claim, were obviously awaiting the GSA accounting and report that was being finalized.

It appears from an examination of the record that the awaited report was transmitted to the parties on June 23, 1967, approximately one month after the settlement agreement had been entered into by the parties.

On October 6, 1969, after stating their exceptions to the final GSA report, appellees filed a pleading entitled "Motion for Leave to Sever from Docket No. 363 Claims Identified as Docket No. 363A and Docket No. 363B." Based on the contents of the Second Claim of Docket No. 363, the appellees restated the alleged wrongs as two separate claims for relief. The first, found in Docket No. 363A, had as its plaintiffs the Sisseton and Wahpeton Tribes of North Dakota and claimed the taking of the Devils Lake Reservation of North Dakota by the appellant through the Act of April 27, 1904 (33 Stat. 319). The second, found in Docket No. 363B, had as its plaintiffs the Sisseton and Wahpeton Tribes of North Dakota and the Sisseton and Wahpeton Tribes of South Dakota. Docket No. 363B complaint prayed for the fair market value of land ceded by several other treaties and agreements between the United States and the appellees. The Commission concluded, on December 10, 1969, that the language of the Second Claim of Docket No. 363 was broad enough to include the two newly-stated claims and, therefore, allowed the amended petitions to be filed over the objection of the appellant that the claim was barred by limitations (22 Ind. Cl. Comm. 226). (In its written briefs and oral argument before this court, the appellant has additionally raised the issue of *res judicata* as to the issues presented in Docket No. 363A based on the 1967 settlement. The disposition of that defense will be discussed in Part II of this opinion.)

On January 21, 1970, the Commission ordered separate trials in Docket Nos. 363A and 363B.[5] The recognized title claim for the value of the Devils Lake Reservation (Docket No. 363A) was tried on May 14, 1971, both as to title and value. On June 30, 1973, the Commission decided that the United States recognized the title of the appellees by the Treaty of February 19, 1867 (*Lower Sioux Indian Community in Minnesota* v. *United States*, 30 Ind. Cl. Comm. 463 (1973)).

That proceeding divided the land into six categories for valuation purposes, as follows:

> 1. Claim for use of 11,420 acres for a military reserve (1867–1890).
> 2. Claim for 64,000 acres excluded from the reservation by erroneous survey in 1875.
> 3. Claim for Sections 16 and 36 in each township of the reservation, or lands in lieu thereof, granted to the State of North Dakota by Section 5 of the Act of April 27, 1904, c. 1620, 33 Stat. 319.
> 4. Claim for not to exceed 900 acres reserved for church, mission, and agency purposes and 1,600 acres reserved for the Fort Totten Indian School, under Section 4 of the Act of April 27, 1904, *supra.*
> 5. Claim for 960 acres the President reserved for a public park by proclamation dated June 21, 1908, pursuant to Section 4 of the Act of April 27, 1904, *supra.*
> 6. Claim for all the unallotted lands of the Devils Lake Indian Reservation, including the Fort Totten Military Reserve, disposed of under the general provisions of the homestead and town-site laws of the defendant, at prices fixed by the 1904 Act, pursuant to Section

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[5] Docket No. 363B, the aboriginal title claim and the Fifth Amendment taking claim was tried in October of 1970 on the issue of aboriginal title. The appellant, herein, has informed this court that the case has "been briefed and is now under submission to the Commission." [Appellant's Brief on Appeal to this court, p. 6.]

> 4 of the Act of April 27, 1904, *supra*, excepting lands identified in Items 2 through 5 above.

The Commission concluded that there was a Fifth Amendment taking of the six items by the appellant, under the doctrine of *Three Affiliated Tribes of the Fort Berthold Reservation* v. *United States*, 182 Ct. Cl. 543, 390 F. 2d 686 (1968). Valuation was determined, and final judgment was entered February 27, 1974 (*Lower Sioux Indian Community in Minnesota* v. *United States*, 33 Ind. Cl. Comm. 389 (1974)).

The issues presented in this appeal are as follows: (1) Whether the original Docket No. 363, Second Claim, was sufficiently broad to permit the amended claim in Docket No. 363A, and (2) Whether the issue of *res judicata* is before the court for review and, if so, whether it is a valid bar to the action as presented in Docket No. 363A.

For reasons stated herein, we answer issue (1) in the affirmative; the first part of issue (2) in the negative. Given our decision concerning the first part of issue (2), an answer to the second part of issue (2) is not required.

## I.

The Indian Claims Commission was created to hear and determine a very broad category of claims that may have accrued to the various constituents of Indian extraction against the United States since the beginnings of our American history, "notwithstanding any statute of limitations or laches." 25 U.S.C. § 70a. The enactment itself, though, limits jurisdictionally the time within which claims must be filed to be heard by the Commission or, for that matter, any authority. 25 U.S.C. § 70k reads:

> The Commission shall receive claims for a period of five years after August 13, 1946, and no claims existing before such date but not presented within such period may thereafter be submitted to any court or administrative agency for consideration, nor will such claim thereafter be entertained by the Congress. Aug. 13, 1946, ch. 959, § 12, 60 Stat. 1052.

In effect, pre-August 13, 1946 causes of action were either presented before August 13, 1951 or forever relinquished.

The original petition, Docket No. 363, Second Claim, was filed within the requisite time.[6] The crux of the issue at bar is whether the amendment to the original petition as stated in Docket No. 363A, filed on October 6, 1969, a date after the jurisdictional time for filing had elapsed, is to be permitted to relate back in time to the initial filing date. If the amendment is permitted to relate back to the original date of filing, the Commission then had the authority to examine the merits of the claim as stated in the amended petition. If the amendment is not permitted to relate back to the original date of filing, the Commission then did not have the authority to examine the merits of the claim as stated in the amended petition, but would then have only the power to examine the claim as stated in the original presentment.

The proper application of the law in determining whether a claim, as stated in an amended petition, is timely or not was explained in *Snoqualmie Tribe of Indians* v. *United States*, 178 Ct. Cl. 570, 372 F. 2d 951 (1967). In *Snoqualmie* we noted that section 70k, 25 U.S.C., "bars claims existing before August 13, 1946, 'but not presented within' five years thereafter." 178 Ct. Cl. 570, 586, 372 F. 2d 951, 960. The key to the inquiry, we determined, was whether the newly-stated claim had been "presented" in the original petition. After a determination that a liberal construction was required by the remedial nature of the Indian Claims Act (*United States* v. *Seminole Nation*, 146 Ct. Cl. 171, 173 F. Supp. 784 (1959); *Otoe and Missouria Tribe of Indians* v. *United States*, 131 Ct. Cl. 593, 131 F. Supp. 265 (1955), *cert. denied*, 350 U.S. 848), we construed the word "presented" to mean that the adverse party be given formal and reasonable notice that a claim is being asserted against it. *Snoqualmie Tribe of Indians* v. *United States*, *supra*.

The review, therefore, must determine if the defendant was apprised or *notified* of the situation to which it may be held responsible. "In other words, the inquiry [test] in a determination of whether a claim should relate back will focus on the notice given by the general * * * situation set forth in the original pleading." *Snoqualmie Tribe of Indians* v. *United States*, 178 Ct. Cl. 570, 587, 372 F. 2d 951, 960 (1967).

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[6] Albeit, just barely, the petition in Docket No. 363 was filed on August 11, 1951. The last day in which filing would have been permitted was August 13, 1951.

In reaching the above rule of construction we simultaneously examined the Commission's Rule 13(c) which by its terms permits certain amended pleadings to relate back to the date of the original pleading. Commission Rule 13(c) states:

> Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading.

The rule, as does the statute, requires the test of notice if circumvention of a time limitation is to be permitted on the theory of relation back. In fact, the rule defines that notice, permitting "relation back," is present only if the amendment arose out of the same "conduct, transaction, or occurrence" as presented in the original pleadings.[7] The *Snoqualmie* case has been affirmed and followed by other cases determining the validity of an amended petition permitted by the Commission. *Sioux Tribe* v. *United States*, 205 Ct. Cl. 148, 500 F. 2d 458 (1974); *United States* v. *Northern Paiute Nation*, 183 Ct. Cl. 321, 393 F. 2d 786 (1968).

In the present case, the Second Claim pleaded in the original petition was drafted in very broad terms.[8] The obvious intention of the claim was to thereby encompass any claims that the appellees might have against the appellant. In so doing, we can say without hesitation that language was used in the original petition which should have put the appellant on notice as to the transactions and occurrences that appellees could rely upon to claim that certain lands of the appellees were taken by the government. A close examination of some of the pleadings as set forth in Docket No. 363, Second Claim, with the pleadings of Docket No. 363A,[9] will

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[7] It should be pointed out that the Commission Rule 13(c) is identical to our Rule 39(c) and the Federal Rules of Civil Procedure 15(c). *See, Snoqualmie Tribe of Indians, supra,* at 587, n. 5.

[8] The Second Claim in Docket No. 363 is reproduced herein for the examination of the reader:

SECOND CLAIM

"14. Under and by virtue of various statutes, treaties and administrative acts, the defendant has been obligated to pay various sums in money and goods to the petitioners, has invested and held for investment various funds belonging to the petitioners, and has managed and disposed of property, both real and personal, belonging to the petitioners.

"15. In the course of its management and control, the defendant at various times:

"(1) Has paid out sums belonging to the petitioners to persons not entitled to receive the same;

"(2) Has sold, rented or otherwise alienated property, including lands, belonging to the petitioners in an improvident manner;

"(3) Has unlawfully induced the petitioners to consent to the use of their funds for the payment of alleged debts never incurred by the petitioners;

(Continued)

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(Continued)

"(4) Has taken unto itself lands and other property belonging to the petitioners;

"(5) Has profited at the expense of the petitioners by its management and control of petitioners' funds and property;

"(6) Has enabled its non-Indian citizens to profit at the expense of the petitioners by the defendant's management and control of petitioners' funds and property.

"16. All of the records of the defendant's transactions in connection with the petitioners' funds and property including lands are in the exclusive custody and control of the defendant. The defendant has never disclosed to the petitioners the manner in which it has carried out its obligations to the petitioners and has never rendered to the petitioners an accounting of such obligations.

"WHEREFORE, the petitioners pray:

"(1) For a full and complete disclosure, accounting and report as to all of petitioners' property, both real and personal, which has come into the possession of the defendant and as to all funds payable to the petitioners by the defendant;

"(2) For a judgment as their interests may appear for such sums and the value of lands or other property which may be found by this Commission to be due to the petitioners;

"(3) For such other relief as this Commission may deem just, and which is consonant with fair and honorable dealings."

[9] The essential parts of the amended pleading, Docket No. 363A, are reproduced herein for the examination of the reader:

"6. By the Act of April 27, 1904, *supra*, the United States, without the consent or agreement of the Band, took property of the Band as follows:

"a. All of the unallotted lands of the Devils Lake Indian Reservation, including the Fort Totten Military Reserve, for disposal under the general provisions of the homestead and town-site laws of the defendant, at prices fixed by the 1904 Act, excepting from such disposal, 6,160 acres required for future allotments and excepting lands identified in subparagraphs b, c, and d below. (Sec. 4.) The taking was as of the dates of the patents.

"b. Sections 16 and 36, or an equivalent of two sections in each township of the reservation, to be paid for by the United States at the rate of $3.25 per acre as fixed by the 1904 Act, and simultaneously granted by the defendant to the State of North Dakota. (Sec. 5.) The taking was as of the date of the 1904 Act, or as of the dates title passed to the State of North Dakota, i.e., the dates of approval of the surveys of the school sections or lieu lands.

"c. Lands, not to exceed 900 acres, for church, mission and agency purposes and two and one-half sections of land reserved for the Fort Totten Indian School, to be paid for by the United States at the rate of $3.25 per acre as fixed by the 1904 Act. (Sec. 4).) The taking was as of the date of the 1904 Act, or as of the dates the reserves were identified and set aside.

show how embryonic the original pleading was to the amended pleading. Paragraph 14 of Docket No. 363, Second Claim, states that the defendant "has invested and held for investment various funds belonging to the petitioners, and has *managed and disposed of property, both real and personal, belonging to the petitioners*." [Emphasis added.]

Paragraph 6(a), of Docket No. 363A pleadings, claims that a wrong was committed upon the appellees when the Act of April 27, 1904, *supra*, took "[a]ll of the unallotted lands of the Devils Lake Indian Reservation * * * for disposal under the general provisions of the homestead and town-site laws of the defendant, at prices fixed by the 1904 Act * * *." We think the broad, but permissible,[10] allegation of the paragraph 14 claim was adequate notice of the more specific Docket No. 363A paragraph 6(a) claim, amended after the appellees had received their copy of the GSA accounting and report.

Paragraph 15, clause (2) of Docket No. 363, Second Claim, states that in the course of its management and control the defendant "[h]as sold, rented or otherwise alienated

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"d. A tract of about 960 acres that the President was authorized to reserve for a public park. The tract embraced Sullys Hill in the northeastern portion of the abandoned military reservation. (Sec. 4.) By Proclamation dated June 21, 1908, the President reserved the 960 acres. The taking was of the date of the 1904 Act, or as of June 21, 1908.

"The 1904 Act directed that the proceeds from the disposition and acquisition of the land under subparagraphs a, b, and c above, be paid to the Indians of the Devils Lake Indian Reservation. (Sec. 6.) By Section 17 of the Act of April 4, 1910, c. 140, 36 Stat. 269, 279, Congress appropriated $3,120, representing $3.25 per acre for the 960 acres identified in subparagraph d above.

"WHEREFORE, judgment for the Sisseton and Wahpeton Band of Sioux Indians of North Dakota, is prayed as follows:

"1. For the fair market value of the lands taken, as of the date or dates of taking, plus just compensation, measured in terms of interest at not less than 5% per annum from the date or dates of taking, less any payment made by the United States.

"2. For such other relief as may be just and equitable and fair and honorable under the Indian Claims Commission Act."

[10] We take notice of the fact that Rule 7(a), General Rules of Procedure, Indian Claims Commission, this court's Rule 32(a) and the Federal Rules of Civil Procedure 8(e)(1), are substantively the same. As to interpretation of the Federal Rule 8(e)(1), the courts have held, that the fact that an [original] pleading is general and not specific does not jeopardize the validity of the complaint. The purpose of a complaint is to give "fair notice * * * of the nature and basis of the claim asserted and a general indication of the type of litigation involved." [*Continental Collieries, Inc.* v. *Shober*, 130 F. 2d 631, 635 (3d Cir. 1942).] Wherever additional facts are necessary to prepare for trial the various forms of discovery will be available to fill the void. *Burriss* v. *Texaco, Inc.*, 361 F. 2d 169 (4th Cir. 1966); *Leas* v. *General Motors Corp.*, 278 F. Supp. 661 (E.D. Wis. 1968).

property, including lands, belonging to the petitioners in an improvident manner." Paragraphs 6(b) and (c) of Docket No. 363A are comparable in that they state claims for lands which the United States, through the Act of 1904, granted to the state of North Dakota and various other churches, schools and agencies, land which belonged to the appellees. Further, that such transactions were compensated for, but that the compensation granted therein was wholly unconscionable. Once again we see no other distinction in the two pleadings other than the fact that Docket No. 363A pronouncements are more definite as to specifics than the Docket No. 363, Second Claim statements, a practice which is not condemnable under modern notions of pleadings. *See* n. 10, *supra.*

We hold that the original petition in Docket No. 363, Second Claim, gave fair and adequate notice to the government of the transactions and occurrences that were later more specifically claimed in Docket No. 363A. The action of the Commission, permitting the amended complaint, was proper and it thereby had the authority to make a determination as to the merits of the claims stated in Docket No. 363A. (*See, Yankton Sioux Tribe* v. *United States*, 175 Ct. Cl. 564 (1966) for a similar conclusion on comparable facts, decided prior to the *Snoqualmie* case, *supra.*)

In our holding, we have determined that the original pleading had sufficiently apprised the government of the transactions and occurrences which it would be required to defend itself against. We thereby allowed the amended pleading. The government in its brief and in oral argument before this court contended that appellees should not now be permitted to claim a Fifth Amendment taking after presenting it for so many years as a demand for an accounting.

We cannot agree that the Docket No. 363, Second Claim, was a demand for an accounting and no more. To begin with, the title to the pleadings reads "Claims Relating to Treaty of 1858 for General Accounting *and Other Relief.*" [Emphasis added.] Although the appellees were obviously thinking that the situation which they were addressing in the petition could be solved by an accounting, they seemingly realized that future proceedings would produce a greater understanding of the nature of the occurrence stated in the petition, and that such in turn may change the relief that must be prayed for in the petition. In their wisdom they so provided for themselves. After a careful reading of the substance of the pleadings (which is unquestionably more determinative to an understanding of the nature of the complaint than the caption—but in this case both prove our point), we conclude that appellees, although believing that an accounting would be an appropriate remedy, were not limiting themselves to that alone.

The government also asserted that an accounting cannot mushroom into a Fifth Amendment taking against the United States, since the United States cannot act as a fiduciary (holding land in trust for the Indians) and a sovereign (exercising the power of eminent domain). *Fowle* v. *Lawrason*, 30 U.S. (5 Peters) 495 (1831). On behalf of this statement, the appellant cites *Three Affiliated Tribes of the Fort Berthold Reservation* v. *United States*, *supra* at 553. The citation refers to this court's discussion of Congress' plenary power to manage and control tribal Indian affairs, including their lands and funds. A spate of cases is cited therein to support that power. After, but not covered by, the given citations, the court in *Three Affiliated Tribes of the Fort Berthold Reservation*, *supra* at 553, states:

> It is obvious that Congress cannot simultaneously (1) act as trustee for the benefit of the Indians, exercising its plenary powers over the Indians and their property, as it thinks is in their best interests, and (2) exercise its sovereign power of eminent domain, taking the Indians' property within the meaning of the Fifth Amendment to the Constitution * * *.

In light of our determination that the petition prayed for relief under an accounting *and* for a Fifth Amendment taking, and since alternative pleadings are permitted (General Rules of Procedure, Indian Claims Commission, section 7(a)(2)),[11] we have no need to confront the issue of whether the government can wear two hats, and be, at the same time, a trustee for the benefit of the Indians' land, and a sovereign exercising eminent domain upon the same Indian land.

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[11] Commission Rule 7(a)(2) reads, in part:

"* * * A party may also state as many separate claims or defenses as he has, regardless of consistency and regardless of the nature of the grounds on which they are based."

The government has additionally asserted, under the first issue of this case, that the facts in this case had been previously litigated (*Sisseton and Wahpeton Indians* v. *United States*, 58 Ct. Cl. 302 (1923),[12] *cert. denied*, 275 U.S. 528 (1927), after passage of a special act authorizing appeal, *aff'd on appeal*, 277 U.S. 424 (1928)), that the appellee knew this case's specifics at the time of the filing of the original petition and did not need the GSA report and accounting to file a more concise and direct pleading. Again, we do not agree. The issue of whether the *Sisseton and Wahpeton Indians* case, *supra*, shows prior knowledge on the part of the appellees of the facts of this case, was never presented to the Commission as a reason for denying the amended pleading. A defense neither pleaded nor proved, or in some other way demonstrated in a proper manner before the Commission, is waived on appeal to this court. *Turtle Mountain Band of Chippewa Indians* v. *United States*, 203 Ct. Cl. 426, 490 F. 2d 935 (1974). Even if we permitted the issue of the previous litigation to be raised to show knowledge of more specifics we would have to find against the government. The government had all the information (all records as to all accounts held on behalf of appellees) in its possession. The appellees had none, until the GSA report was filed in 1967. A careful reading of the prior litigation reveals that there was no showing in the report that any knowledge as to the extent and handling of the appellees' accounts was revealed by the government. In fact, it seems that the Indians knew really very little about their state of financial being. (What they did know and plead therein was that the government under various statutes and treaties was in charge or control of accounts held on their behalf.) Since the then appellees did not receive judgment in the case, we cannot now presume that they were ever fully apprised of their situation until the GSA accounting and report of 1967. What we can say is that once they had that report, they became aware that the Docket No. 363, Second Claim, could be better stated. We conclude that the obvious realities of the situation show that the accounting and report gave appellees a better understanding of the case at bar, an understanding that appellant, we may presume, had since it was in control of the records.

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[12] Jurisdiction for the court's consideration of the claim reported at 58 Ct. Cl. 302, was granted in the Act of April 11, 1916, 39 Stat. 47. Jurisdiction was therein limited to rights which may have accrued under treaties and acts of Congress. The present suit is on a theory of Fifth Amendment taking. *See, Lower Sioux Indian Community in Minnesota* v. *United States*, 30 Ind. Cl. Comm. 463, 466–469, as to argument of *res judicata*. *See*, n. 14, *infra*.

We, therefore, allow the amendment under Commission Rule 13(c).

## II.

The issue has been presented to this court on appeal, by the appellant, that the claim for the Fifth Amendment taking of the Devils Lake Reservation land is *res judicata* under the consent judgment enforcing the settlement agreement. Before this court could ever reach a determination of the validity of that contention we would first have to overcome the reply contention of the appellees that the issue is not properly before this court. After a scrutinous examination of the record and the law we come to the conclusion that the appellees' reply to the issue is tenable.[13] We, therefore, cannot entertain the issue presented by appellant.

The defense of *res judicata* that the government raises before this court, and the assertions and arguments that the government makes in its brief, were never before presented in this case.[14] In short, the issue of *res judicata* was not properly presented, litigated or adjudicated below.

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[13] Although appellees' basic contention is accepted by this court, we base our decision on cases and rules of procedure substantially distinct from those propounded by appellees in their brief before the court.

[14] The government's *res judicata* argument to the Commission was made on the claim for a Fifth Amendment taking of the 64,000 acres excluded by the erroneous survey of 1875. Reference was made based on the case of *Sisseton and Wahpeton Indians* v. *United States, supra.* The Commission passed upon the contention notwithstanding the fact that the issue of *res judicata* was not raised by pleading or in pre-trial hearings, and no argument or evidence was presented during the proceedings to support the government's contention. The Commission's opinion on the point was stated in 30 Ind. Cl. Comm. 463, 466–469, and is reproduced herein for reference and distinction as to the contention at bar:

"The defendant also asserts that the claim for a Fifth Amendment taking of approximately 64,000 acres [footnote 1 omitted] excluded by the erroneous survey of 1875 is res judicata. Defendant refers to *Sisseton and Wahpeton Indians* v. *United States,* 58 Ct. Cl. 302 (1923), *cert. denied,* 275 U.S. 528 (1927), *aff'd on appeal,* 277 U.S. 424 (1928), and states that the present plaintiffs filed the petition in the Court of Claims pursuant to a special juris-

(Continued)

The appellant, on the other hand, contends that it did present the question of *res judicata* under the consent judgment. The government admits that it was raised "*sub silentio*," but that such was sufficient to preserve the point for

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(Continued)
dictional act of Congress approved April 11, 1916, 39 Stat. 47; and that the issues in that action were the same as those in issue herein.

"On March 17, 1917, the Sisseton and Wahpeton Bands filed a petition in the Court of Claims pursuant to the aforesaid jurisdictional act. The petition included several claims, among them a claim based on the loss of the 64,000 acres excluded from the Devils Lake Reservation by the erroneous survey of 1875. The court dismissed the petition for reasons more particularly discussed hereafter.

"The defendant refers to the finding by the Court of Claims that plaintiffs had been paid $1.25 per acre, or $80,000.00, for the 64,000 acres of land. The court also found plaintiffs had been paid $421,850.21 up to 1917 for loss of the unallotted lands of the Devils Lake Reservation, as well as for the claim growing out of the erroneous survey and timber taken from the reservation by the Military Forces of the United States. Such payment was made pursuant to an agreement between the bands and the United States on November 2, 1901, which was "amended and confirmed" by the Act of April 27, 1904, 39 Stat. 47 [*Sic,* 33 Stat. 319.] The Court of Claims concluded that the claim for the value of the erroneous survey lands was without merit for the reason that the bands had already been paid twice for this portion of the claim.

"The Commission finds that res judicata does not apply here. The aforesaid jurisdictional act of Congress, conferring jurisdiction on the Court of Claims to hear, determine and render judgment in claims of the Sisseton and Wahpeton Bands of Sioux Indians against the United States, provided, among other things, as follows:

'* * * That all claims * * * shall be submitted * * * for the amount due or claimed to be due said bands from the United States under any treaties or laws of Congress; and jurisdiction is hereby conferred upon the Court of Claims to hear and determine all claims of said bands against the United States and also any legal or equitable defense, set-off, or counterclaim which the United States may have against said Sisseton and Wahpeton bands * * * 39 Stat. 47.' [*Sic,* Act of April 11, 1916]

"The Court of Claims stated in Sisseton and Wahpeton Indians, *supra,* at page 329, as follows:

'The plaintiff Indians manifestly misapprehended the scope and character of the jurisdictional act and the limitations of the court thereunder * * * Our jurisdiction is limited to rights which may or may not accrue under treaties and acts of Congress. When Indian rights of property are fixed by the terms of treaties and statutes we are bound to accept them as so fixed.* * *'

"The Commission finds that the jurisdictional act conferring jurisdiction on the Court of Claims in *Sisseton and Wahpeton Indians, supra,* was strictly construed by the court to cover only those claims which might arise under the terms of treaties or laws of Congress; and that a decision regarding claims thereunder asserted cannot be res judicata in connection with the instant claim filed under the Indian Claims Commission Act of 1946 for just compensation based not on laws or treaties, but on a Fifth Amendment taking. *Creek Nation* v. *United States,* 168 Ct. Cl. 483, 495 (1964).

"Since we are able to dispose in this way of the defense of res judicata raised by defendant, we need not deal with the question raised by plaintiff of the effect of the pretrial order on the subsequent course of action of the case. (The case was tried on the issues and facts set forth in the pretrial order of March 25, 1970. The issue of res judicata was not raised at the pretrial hearing or at the trial, and no argument or evidence was previously offered to support defendant's contentions.)"

appeal. On behalf of the *sub silentio* argument the government points to the following statements of its counsel, which were found in the record. First, in "Defendant's Response and Memorandum to Motion for Leave to Sever from Docket No. 363, Claims Identified as Docket No. 363A and 363B" the appellant (government) stated, in part:

> All of these claims [Docket Nos. 142 and 359–363, inclusive] were tried upon the questions of liability and land value. *Sisseton and Wahpeton Bands, et al.* v. *United States*, 10 Ind. Cl. Comm. 137 (1962), modified 163 Ct. Cl. 329 (1963). After determination of liability, but before the Commission reached a decision upon value, such claims were compromised and settled by payment by defendant for the sum of $12,250,000. *Sisseton and Wahpeton Bands, et al.* v. *United States*, 18 Ind. Cl. Comm. 477 (1966). The accounting claim (Docket No. 363, second claim) was not included in the settlement negotiations because at the time of settlement the accounting report had not been received from the General Services Administration.
>
> The claims alleged in proposed Docket Nos. 363–A and 363–B are of the same type as made in Docket Nos. 142 and 359–363, inclusive, and already settled by compromise * * *.

Second, the government shows that at oral argument on appellees' motion on November 20, 1969, counsel for the government opened his argument by stating:

> May it please the Commission, this [is] an accounting action and it has been referred to always as an accounting action and even in the settlement proceedings that we had previously which have been referred to here, it was referred to as a general accounting action which was accepted [excepted] from that settlement. That settlement [was] comprised of several land claims, several large land claims that these same petitioners presented and which have been disposed of.
>
> This has always been referred to as the accounting action. Now, as Mr. Sonosky has already stated, these cases, one 363A and one 363B, 363A is a claim based on alleged unlawful taking of land. The other one which Mr. Sonosky has already stated is based on alleged unconscionable consideration made for some 11 million acres of land. That also is a land claim. [Brackets were supplied by the appellant in its reply brief.]

In conclusion, the government asserts that it was not necessary to use any magic words such as *res judicata* to assert the defense.

Commission Rule 11(b) states, in part:

> * * * Every defense to a claim for relief * * * except a counterclaim or set-off by the United States, shall be asserted in the responsive pleading thereto if one is required * * *.

On the same point (affirmative defenses) this court's Rule 37(b) states:

> In pleading to a preceding pleading, a party shall set forth affirmatively * * * *res judicata* * * * and any other matter constituting an avoidance or affirmative defense. [Emphasis added.]

Federal Rules of Civil Procedure, 28 U.S.C. Rule 8(c) is exact in comparison with our rule.

The Supreme Court has recently stated:

> *Res judicata* and collateral estoppel are affirmative defenses that must be pleaded. Fed. Rule Civ. Proc. 8(c). The purpose of such pleading is to give the opposing party notice of the plea of estoppel and a chance to argue, if he can, why the imposition of an estoppel would be inappropriate. [*Blonder-Tongue Laboratories, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313, 350 (1971).]

Appellant not only failed to plead *res judicata*, but failed to include the issue in the pre-trial order, present evidence of the plea at trial, or in any other manner *affirmatively* present the issue to the Commission. The government comes now, to this court, and relies on elusive phraseology and cries out, "sub silentio." We lack knowledge of any rule of law which would permit the appellant to so niggardly state a defense (which otherwise would require demonstrative extrapolation), fail to raise it before the Commission, and then contend the issue upon appellate review.[15] On the contrary, we are aware of an abundance of case law stating otherwise.

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[15] Appellant's cases, which are cited on behalf of its contention, are all quite readily distinguishable. *Imperial Insurance Inc.* v. *Employers' Liability Assurance Corp.*, 442 F. 2d 1197, 1201 (D.C. Cir. 1970) concerns review of instructions presented to a jury at trial, not procedural requirements of affirmative defenses. In any event, in *Employers', supra,* the court accepted

This court cannot review what the Commission did not decide and contrary to procedural requirements was not asked to decide. In fact, we are without authorization to make such a review. *Blonder-Tongue Laboratories, Inc.* v. *University of Illinois Foundation, supra* at 350; *McCullough* v. *Kammerer Corporation*, 323 U.S. 327, 328 (1945); *Turtle Mountain Band of Chippewa Indians* v. *United States, supra.*

The decision of the Indian Claims Commission is

*Affirmed.*

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## K. C. WEST v. THE UNITED STATES

[No. 462-73. Decided July 11, 1975]

### ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Civilian pay; dismissal.**—Plaintiff, a Negro and former steward employed by the National Oceanic and Atmospheric Administration, Department of Commerce, was dismissed from duty on charges. Plaintiff appealed to the Civil Service Commission Regional Office and, after completion of an investigation of plaintiff's interim discrimination complaint, the removal was sustained following a hearing, the CSC finding race was not a factor leading to the adverse action. The Board of Appeals and Review affirmed the decision. Plaintiff seeks here reinstatement and back pay. It is *held* that there was substantial compliance by the administrative agencies with applicable statutes and regulations, that their actions and decisions were not arbitrary or capricious and that their decisicns are supported by substantial evidence. Plaintiff's motion for summary

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the appeal because there was a "full exchange between court and counsel at which *Employers'* position had been rejected." In *United States* v. *Barndollar & Crosbie*, 166 F. 2d 793, 796 (10th Cir. 1948) there was no formal taking of exception to findings of fact. The court ruled that such would not be necessary if the objection was made "known". We doubt very much that appellant, through its quoted sentences, made it "known" to all parties that it was contending *res judicata*. The standard for taking exception to findings of fact, in any case, is different and probably less strict than the standard for affirmative pleading. In *United States* v. *Harue Hayashi*, 282 F. 2d 599, 601 (9th Cir. 1960) it was contended that a motion for a new trial should have been made prior to any appeal on an award of damages. It was held, based upon an analysis of the Federal Rules of Civil Procedure, 28 U.S.C., that such was not necessary and, in any case, an objection was made to the award granted. Finally, in *Lipman* v. *Arlington Seating Co.*, 192 F. 2d 93 (7th Cir. 1951), the court determined that a defendant was not required to request a specific finding on lack of mutuality in order to raise the defense on appeal. Fed. R. Civ. P. 52(a). In non-jury cases, *requests for findings* are not necessary for review. Objection to all adverse findings may be presumed. We cannot presume *res judicata* unless specifically referred to.

**judgment is denied, defendant's cross-motion is granted, and the petition is dismissed.**

**Evidence; hearsay; admissibility of; administrative hearings.**

**[1] It is not error in a Civil Service Commission dismissal hearing to permit introduction by the Government of a report of discrimination proceedings instituted by plaintiff showing no discrimination, even though the report contained hearsay statements.**

**Officers ⚷ 72(1)**

**Evidence; hearsay; admissibility of; administrative hearings.**

**[2] Hearsay is admissible in an administrative hearing and can constitute substantial evidence if it has sufficient probative force. *Richardson* v. *Perales*, 402 U.S. 389 (1971).**

**Admin Law ⚷ 461**

*Sidney J. Strong*, attorney of record for plaintiff.

*Donnie Hoover*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

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Before SKELTON, KUNZIG, and BENNETT, *Judges*.

PER CURIAM: The plaintiff, K. C. West, a veteran's preference employee, was employed as chief steward by the National Oceanic and Atmospheric Administration (NOAA) of the Department of Commerce aboard the ship *Davidson*. He had been employed by NOAA since January 27, 1965, when he retired from the Navy after 20 years service. He had been chief steward since January 16, 1970.

On or about June 29, 1972, plaintiff was notified of the proposal to remove him from his position on the following charges:

> 1. Unauthorized use, possession and disposition of Government provisions and personnel. (Giving away meat from the ship *Davidson*, and ordering a subordinate messman to get steaks from the *Davidson* and bring them to plaintiff in a tavern.)
> 2. Negligence in the performance of his duties. (Failure to obtain sufficient milk and bread for the crew of the *Davidson*.)
> 3. Unwarranted tardiness. (Failure to report for duty on May 1, 1972, at the required time.)

Plaintiff replied to the charges through counsel on July 20, 1972. Thereafter, on August 22, 1972, the chief of the personnel division issued his decision removing plaintiff, effective September 1, 1972. Subsequent to the decision of removal, plaintiff filed a formal complaint of discrimination on account of race on August 29, 1972. (Plaintiff is a Negro.)

Plaintiff elected to appeal the agency's decision to the Civil Service Commission's (CSC) Regional Office in Seattle, Washington. Proceedings were suspended pending an investigation of the discrimination complaint, which was completed February 16, 1973. Plaintiff requested a hearing, which was held in March and May 1973. The appeals examiner rendered his decision sustaining the agency's removal of plaintiff on the above charges, and finding race was not a factor leading to the adverse action against the plaintiff. The plaintiff then appealed to the Board of Appeals and Review (BAR), which affirmed the decision of the CSC Regional Office on September 27, 1973. The plaintiff then filed this suit for reinstatement and back pay, claiming various substantive and procedural errors. The case is before us on cross-motions for summary judgment.

One of plaintiff's principal complaints is that it was error for the discrimination report to be introduced into evidence at the hearing. The report showed there was no discrimination. The plaintiff contends that the report contained hearsay statements and that since he initiated the investigation he should have the right to decide whether it should be put into evidence. We find no basis in the law for any such theory. The agency was entitled to consider the report. Furthermore, the fact that the report contained hearsay statements did not make it inadmissible. It is well settled that hearsay is admissible in an administrative hearing and can constitute substantial evidence if it has sufficient probative force. *See Richardson* v. *Perales*, 402 U.S. 389 (1971).

We conclude that there was substantial compliance by the agency, the CSC and the BAR, with applicable statutes and regulations; that their actions and decisions have not been arbitrary or capricious; and that their decisions are supported by substantial evidence.

Accordingly, plaintiff's motion for summary judgment is denied, and that of the defendant is granted, and plaintiff's petition is dismissed.

518 F. 2d 1384

# JAMESBURY CORPORATION v. THE UNITED STATES

[Nos. 189-63 and 520-71. Decided July 11, 1975]

ON THE PROOFS

**Patents; patentability; validity; misjoinder of inventors.**—Plaintiff seeks to recover reasonable and entire compensation for the unauthorized use or manufacture by or for defendant of the ball valve described in claims 7 and 8 of U.S. patent No. 2,945,066. After a trial on liability, a commissioner of this court filed a recommended opinion in which he concluded that claims 7 and 8 were valid and infringed by defendant's use of the devices. Thereafter, however, the parties stipulated to stay further proceedings until ownership of the patent was settled, having been put in issue in an infringement action brought by the present plaintiff in a district court of Massachusetts. Following a trial, the district court entered judgment for plaintiff, and this judgment was affirmed by the First Circuit Court of Appeals. Plaintiff moved to remand the present cases to the trial division for further proceedings and additional findings of fact (1) concerning an issue raised by the district court, i.e. whether the named inventors "F" and "V" of the patent in suit were joined in a manner irremediably contrary to applicable law; and (2) concerning a patent to Melicher et al. called to plaintiff's attention during settlement discussions between the litigants. An additional trial was conducted. On the issue of misjoinder, the trial judge concluded that inventor "V" made a contribution of crucial importance and that he must be considered a coinventor with "F" of the invention defined in claims 7 and 8, that these claims do not cover the unworkable valve seat designed originally by "F", and that accordingly there is no misjoinder of inventors. On the issue of validity, at the latest trial defendant relied on the Melicher et al. patent and a British patent to Cross. The trial judge concluded that neither patent, considered individually or in combination, discloses a ball valve having a sealing ring with the structure and functional features required to perform the intended purposes of the ball valve defined by claims 7 and 8. The trial judge also concluded that the invention of claims 7 and 8 would not have been obvious to a person of ordinary skill in the art at the time the joint invention was made. The court *affirms* and *adopts* the recommended opinions of the trial division as the basis for its judgment, and *concludes* that claims 7 and 8 are valid and infringed by defendant's unauthorized use of ball valves produced for it by Electric Boat Division of General Dynamics Corp. and by Worcester Valve Co., Inc., and that plaintiff is entitled to recover reasonable and entire compensation therefor.

Judgment is entered for plaintiff with the amount of recovery to be determined under Rule 131(c)(2).

**Patents; validity; presumption of validity; Patent Office consideration of prior art.**

[1] Claims allowed over prior art considered by the Patent Office are presumed patentable.

Patents 🔑 112.3(1)

**Patents; infringement; equivalents, doctrine of.**

[2] A device may infringe a patent claim if the claim reads element for element on the device. Even where the patent claim does not read element for element, if the accused structure performs substantially the same way to obtain the same result, infringement may exist under the doctrine of equivalents. An important factor in determining whether different structures are equivalent is whether persons reasonably skilled in the art would have known of the interchangeability.

Patents 🔑 245(1)

**Patents; inventorship; misjoinder or nonjoinder.**

[3] While it is true that the inclusion of more or less than the true inventors in a patent renders it void, there is a presumption that the inventors named in an issued patent are correct. Since misjoinder is a technical defense, it must be proven by clear and convincing evidence.

Patents 🔑 118.21

**Patents; inventorship; joint inventors.**

[4] A joint invention is the product of collaboration of the inventive endeavors of two or more persons working toward the same end and producing an invention by their aggregate efforts.

Patents 🔑 92

**Patents; inventorship; joint inventors.**

[5] To constitute a joint invention, it is necessary that each of the inventors work on the same subject matter and make some contribution to the inventive thought and to the final result.

Patents 🔑 92

**Patents; inventorship; joint inventors.**

[6] Each joint inventor needs to perform but a part of the task if an invention emerges from all of the steps taken together.

Patents 🔑 92

**Patents; inventorship; joint inventors.**

[7] It is not necessary that the entire inventive concept should occur to each of the joint inventors, or that the two should physically work on the project together. That each of the inventors plays a different role and that the contribution of one may not be as great as that of another does not detract from the fact that the invention is joint, if

each makes some original contribution, though partial, to the final solution of the problem.

Patents ⟹ 92

**Patents; inventorship; joint inventors.**

[8] The conception of an entire device may be due to one person, but if the other person makes suggestions of practical value, which consist in working out the main idea and making it operative, or contributes an independent part of the entire invention, which is united with the parts produced by the other and creates the whole, he is a joint inventor, even though his contribution be of comparatively minor importance and merely the application of an old idea.

Patents ⟹ 92

**Patents; inventorship; joint inventors.**

[9] To claim inventorship is to claim at least some role in the final conception of that which is sought to be patented.

Patents ⟹ 90(1)

**Patents; inventorship; joint inventors; doctrine of "mere suggestions".**

[10] The doctrine of "mere suggestions" denies co-inventorship status to a person who suggests some way to improve an invention casually but takes no further role in fitting the rough suggestion into the scheme of the invention workably.

Patents ⟹ 92

**Patents; claims; construing and interpreting; generally.**

[11] It is fundamental that claims are to be construed in the light of the specification and both are to be read with a view to ascertaining the invention.

Patents ⟹ 157(1)

**Patents; claims; construing and interpreting; file wrapper estoppel.**

[12] An invention is to be construed not only in light of the claims, but also with reference to the file wrapper or prosecution history in the Patent Office.

Patents ⟹ 168(1)

**Patents; claims; construing and interpreting; file wrapper estoppel.**

[13] The doctrine of file wrapper estoppel does not allow recapture of relinquished subject matter. Thus, where the application claims were narrowed and restricted in view of prior art cited by the Patent Office, it is improper to permit an applicant, by way of presentation of a claim in a continuation-in-part application, to recapture the subject matter that he had willingly relinquished.

Patents ⟹ 168(1)

**Patents; validity; presumption of validity.**

[14] The failure of the Patent Office to consider important prior art references during evaluation of a pending application is enough

**to overcome the statutory presumption of validity of an issued patent.**

**Patents ⚿ 112.5**

**Patents; patentability; obviousness; generally.**

**[15] In resolving whether or not a patent meets the requirements of patentability set forth in 35 U.S.C. § 103, consideration must be given to the scope and content of the prior art, the difference between the prior art and the claims in issue, and the level of ordinary skill in the pertinent art. These factual determinations must be made without resorting to the teaching of the patent at bar or the deceptive and oftentimes unwitting use of hindsight.**

**Patents ⚿ 51(1)**

**Patents; patentability; evidence of patentability; secondary considerations.**

**[16] Secondary considerations, such as commercial success, satisfying a long-felt need, and the failure of others, are relevant in evaluating patentability under 35 U.S.C. § 103.**

**Patents ⚿ 36.2(1)**

**Patents; patentability; obviousness; generally.**

**[17] That the device operated with suprising superior results when another's contribution was incorporated speaks to the nonobviousness of the contribution.**

**Patents ⚿ 18**

*Robert F. Conrad*, for plaintiff. *Robert C. Miller*, attorney of record.

*Thomas J. Byrnes*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before COWEN, *Chief Judge*, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

PER CURIAM: These consolidated cases come before the court on defendant's exceptions to the opinion and recommended decision, filed May 16, 1967 [pursuant to then Rule 57(a)], by then Commissioner Donald E. Lane (now Judge of the United States Court of Customs and Patent Appeals) and to the supplemental opinion and recommended decision, filed September 20, 1974 [pursuant to Rule 134(h)], by Trial Judge Joseph V. Colaianni. The court has considered the cases on the briefs and oral argument of counsel. Since the court agrees with the opinions, findings of fact and recommended decisions filed May 16, 1967, and September 20. 1974.

as hereinafter set forth, it hereby affirms and adopts them as the basis for its judgment in these cases. Therefore, the court concludes as a matter of law that claims 7 and 8 of United States Letters Patent No. 2,945,666 are valid and have been infringed by the defendant's unauthorized use of ball valves produced by the Electric Boat Division of General Dynamics Corp. and by Worcester Valve Co., Inc., and that plaintiff is entitled to recover reasonable and entire compensation therefor. Accordingly, judgment is entered for plaintiff with the amount of recovery to be determined pursuant to Rule 131(c)(2).

## OPINIONS OF TRIAL JUDGES

LANE, *Commissioner:* This is a patent suit under Title 28 U.S.C. § 1498 to recover reasonable and entire compensation for the unauthorized use or manufacture by or for the defendant of a patented invention. Plaintiff specifically alleges that ball valves manufactured by Electric Boat Division, General Dynamics Corp. and by Worcester Valve Co., Inc., and procured and used by the defendant embody an invention defined in varying scope in patent claims 7 and 8 of U.S. Letters Patent No. 2,945,666, entitled "Ball Valve." Said patent, referred to hereinafter as the patent in suit, issued to plaintiff on July 19, 1960, on an application for patent filed February 14, 1958, which was a continuation in part of a parent application filed June 11, 1954. After the trial on liability was completed with briefs and requested findings being submitted, plaintiff's ownership of the patent in suit was put in issue by E. W. Bliss Co. in the United States District Court for the District of Massachusetts. In view of the suit in Massachusetts, the parties have stipulated to stay action on the present suit, after commissioner's report has been filed, until the ownership issue has been settled in the Massachusetts District Court. Plaintiff has agreed to dismiss the present suit if the District Court finds against plaintiff on the issue of ownership. The parties have also agreed to defer trial of any accounting issues until the issues of patent infringement and patent validity are decided.

It is concluded that claims 7 and 8 of the patent in suit are valid and that ball valves manufactured by both the Electric

Boat Division, General Dynamics Corp., and by Worcester Valve Co. which were procured and used by the defendant infringe said patent claims.

The patent in suit describes and claims an improved ball valve. A ball valve is used to control the flow of liquids and gases in pipelines and includes a casing adapted to be connected to a pipeline and having a valve chamber with both an inlet and an outlet opening. A ball having a passage extending through it is mounted for rotation in the valve chamber. In one position of rotation, the passage in the ball is alined with the inlet and outlet openings to permit fluid flow through the ball valve and in another position of rotation, the passage is positioned at right angles to the inlet and outlet openings in the valve casing to prevent the flow of fluid.

Prior to the development of the plaintiff's patented valve, ball valves were not generally accepted or used by industry. In early ball valves, the ball with a passage extending therethrough was tightly journaled into the valve chamber. Temperature variations, pressure variations, and/or valve wear, either caused the valve to leak or made it extremely difficult to operate by rotating the ball between open and closed position. Attempts to solve this problem were made by journaling the ball against some material, preferably nonmetallic, in what were known as compression sealing rings placed about the outlet opening and about the inlet opening. The ball was truncated on each side where the passage ends and reduced ball pressure resulted when the ball was placed so that the passage lines up with the openings in the casing in the open valve position. When the ball was rotated to a closed position, the nontruncated portion of the ball pressed into the material of the sealing rings with sufficient force to provide a fluid tight seal. These compression sealing rings made no provision for expansion or contraction of the ball or casing and for valve wear. Compression sealing rings did compensate somewhat for the problems of leakability and ease of ball rotation but not adequately for use in modern industry.

The ball valve which is the subject matter of the patent in suit solved the problems of temperature variation, pressure variation, and valve wear. The patented ball valve employs a novel sealing ring utilizing a principle different from the compression sealing rings which seal by the nontruncated portion of the ball pressing into the material of the sealing rings. The sealing ring of the patent in suit has a portion which flexes with respect to the remainder of the sealing ring and which is known as a lip. This lip projects inward with a graduated stiffness due to its increasing cross sectional shape in the radial direction. The lip is prestressed which causes it to flex into sealing contact or engagement with the ball even when the ball is being rotated. For a more detailed explanation of the patent in suit see finding 10.

After the patented valve was described in several trade journals, over 1,000 inquiries were received which later became purchase orders for the valve. This flow of inquiries and orders grew so fast that plaintiff could not keep up with production orders. Plaintiff grew from a corporation having 3 or 4 employees at the time of the announcement in 1954 to over 550 employees at the time of trial in January 1966. Over 3 million ball valves valued at over $50 million were sold since the announcement in 1954.

In the summer or fall of 1957, an engineer from the Portsmouth Navy Yard approached plaintiff about the possible use of the plaintiff's valve on Navy submarines. Increased size and better hull construction enable the modern submarine to navigate at greater depths. Valves must operate under greatly increased pressure, be able to withstand hydraulic shock caused by depth charges, permit fluids to flow silently, work under problems of corrosion and erosion with sea water, and be remotely operable. No other valve in industry or in prior submarine service except the plaintiff's valves solved all of these problems.

At the request of the Portsmouth Navy Yard, plaintiff's engineers lectured on the theory and function of ball valves to the engineers of the Electric Boat Division, General Dynamics Corp. which was building nuclear submarines but had no ball valves or even contemplated using them. In April 1958, Electric Boat informed plaintiff that they were going to make their own ball valves and no longer needed plaintiff.

Nylon and teflon were available well before plaintiff's ball valve was developed, and defendant's contention that the commercial success of the patented valve resulted from the availability of nylon and teflon is without merit.

Defendant has interposed the usual defenses of the invalidity and/or noninfringement of claims 7 and 8 of the patent in suit. In interposing these defenses, defendant's major contention is that because of the prosecution history of claims 7 and 8 of the patent in suit, the clear language of these claims must be limited. More specifically, defendant argues that although claims 7 and 8 call for a sealing ring and the claim language does not limit whether that sealing ring is placed on the upstream side or on the downstream side of the valve chamber, the prosecution history forces the claims to be interpreted as being limited to a sealing ring on the upstream side of the valve chamber.

Patent claims 7 and 8, set forth in finding 11, define a ball valve comprising a casing, valve chamber having openings, a rotatable ball in the chamber and having a port, and a sealing ring mounted in the chamber around one of the openings, the sealing ring having a lip extending toward the axis of the ring and engaging the ball. Claims 7 and 8 define the lip as free to bend in the axial direction and increasing in thickness outward in the radial direction of the ring, which projects inwardly toward the axis of the sealing ring and sealingly contacts or engages the ball, and which is free to move in the axial direction of the sealing ring. Claim 8 further defines the lip as having one side face disposed toward the ball and one side face away from the ball, which faces diverge from each other substantially uniformly outward in the radial direction of the ring.

The prosecution history of claims 7 and 8 of the patent in suit is discussed in detail in finding 13. Plaintiff urged that claims 7 and 8 distinguished over Saunders' French patent 1,018,974 because the lip on the sealing ring disclosed in Saunders would not seal on the upstream side. It was the patentees' position during the prosecution of the application for patent that if the lip didn't increase in thickness outward in the radial direction as defined in claims 7 and 8 but was uniform in thickness as disclosed in Saunders, the lip would bend at an intermediate point to such an extent that the lip would curl away from the ball and cause a leak on the upstream side. The Patent Office examiner allowed claims on the basis of this argument. The clear language of patent claims 7 and 8 covers either a downstream or an upstream seal. The patentees were not required to argue the advantages of a sealing ring on the downstream side since the lip shown in Saunders would not seal on the downstream side of the valve. The clear language of patent claims 7 and 8 is not limited by the prosecution history to an upstream seal but also covers a downstream seal.

In *O'Brien* v. *O'Brien*, 202 F. 2d 254, 96 USPQ 290 (7th Cir. 1953), the patentee in the prosecution history of the patent there in suit argued that one of the advantages of his invention was that a conventional motor could be used. The allowed claims were not limited to a conventional motor but recited "a motor." The accused construction there was identical to that of plaintiff's device but used an *unconventional* motor. In holding that the prosecution history did not limit the claims to a conventional motor, the court stated:

> It is hardly reasonable to think that the patent would have issued over the prior art merely on this particular feature without including it in the claims which, after all, measure the grant [202 F. 2d at 257, 96 USPQ 293].

In support of its contention that claims 7 and 8 are unpatentable in view of the prior art available at the time the invention was made, the defendant directs attention to several prior patents set forth in the findings. Each of these prior patents discloses a valve having a casing, a valve chamber, and a ball with a passage extending through it which rotates between an open position with the passage alined with the inlet and outlet openings of the valve casing and a closed position where the passage is out of alinement with the openings. Defendant relies particularly on Blevans patent 2,516,947, Australian patent 126,685, and British patent 692,085. Blevans shows a valve having a mechanism for axially moving the core out of engagement with a sealing ring before the core is rotated. The lips of the sealing ring disclosed in Blevans are not always in sealing engagement with the core when the core is rotated from an open position to a closed position or vice versa. Australian patent 126,685 discloses a ball and stem made of one piece which cannot move axially. The sealing rings of flexible material such as rubber may be chamfered where the ball bears against them. Since flexible sealing rings of the Australian patent are firmly against the ball and the ball cannot move axially under fluid pressure, there is no lip free to bend in the axial direction of the sealing ring as defined in claims 7 and 8 in suit. The sealing rings of the Australian patent are in sealing engagement with the ball when fluid pressure acts upon the backs of the sealing rings. Claims 7 and 8 define a sealing ring having a lip which is always in sealing contact with the ball. Defendant has placed particular emphasis on Saunders British patent 692,085. Saunders French patent 1,018,947 (the equivalent of the British Saunders argued here) was considered by the Patent Office when allowing patent claims 7 and 8 here in suit and there is a presumption that these claims are patentable over the Saunders valves. Saunders discloses rubber sealing rings which utilize a compression seal wherein portions of the ball mash the sealing rings. In addition to the compression seal, Saunders discloses a lip on the rubber sealing ring which contacts the ball when fluid pressure forces it against the ball. Saunders' lip does not increase in thickness outward in the radial direction of the sealing ring as required by claim 7 nor does the lip have side faces disposed toward and away from the ball which diverge from each other substantially uniformly outward in the radial direction of the ring as required by claim 8 in suit. Saunders lip is straight edged and of uniform thickness. Plaintiff successfully argued in the prosecution history that a straight-edged lip, like the Saunders lip, would bend at an intermediate point and curl away from the ball to cause a leak. Claims define a lip increasing in thickness outward in the radial direction of the ring patentably distinguished over the Saunders constructions. Defendant's contention that this argument was erroneous is without merit. None of the several cited prior art patents either singly or collectively disclose a ball valve having a sealing ring with the structural and functional features of the ball valve defined in claims 7 and 8 in suit.

Defendant urges that under 35 U.S.C. § 103 it would have been obvious to one skilled in the art to provide the straight-sided sealing rings of Saunders with a tapered lip as shown in Antonelli patent 2,348,587. There is no suggestion in Antonelli that the rubber dual wiping lips there disclosed could be used in a ball valve of the Saunders construction. The Antonelli dual wiping lips are not free to bend axially in the direction of the sealing ring but are compressed downward and would not seal or stay on the valve ball if substituted in the Saunders construction. The Antonelli lips are tapered but to prevent the exterior faces of the lips from being extruded and pinched between the flanges of the sealing ring retaining shell and not to progressively increase the sealing force between the dual lips and the ball. Even if the tapered lip disclosed in Antonelli could be substituted in Saunders, the lip in Saunders is not always in engagement with the ball as required by the claims at issue. Claims 7 and 8 are valid over any attempted combination of Saunders with Antonelli.

In addition, defendant urges that claims 7 and 8 are invalid as indefinite under 35 U.S.C. § 112 because the terms "lip," "axis," "axial," and "radial" are nowhere defined in the specification. This contention is without merit. Claims 7 and 8 are clear and definite to one skilled in the ball valve art when read in light of the specification and drawings. These claims can be easily read on the illustrative drawings and are valid.

Now turning to the issue of infringement, plaintiff alleges that certain ball valves manufactured by Electric Boat Division, General Dynamics Corp. (hereinafter called the Electric Boat ball valve) and that certain ball valves manufactured by the Worcester Valve Co. (hereinafter called the Worcester ball valve), which were procured and used by the defendant, infringe claims 7 and 8 of the patent in suit.

An accused device may infringe the claims of a patent if the patent claim reads element for element on the device. Even where the patent claim does not read element for element, if the accused structure performs substantially the same way to obtain the same result, infringement may exist under the doctrine of equivalents. *Graver Tank & Mfg. Co.* v. *Linde Air Products Co.*, 339 U.S. 605, 85 USPQ 328 (1950). In *Graver Tank*, the Supreme Court indicated that an important factor in determining whether different structures are equivalent is whether "persons reasonably skilled in the art would have known of the interchangeability" of the structures.

Both the Worcester ball valve and the Electric Boat ball valve include a conventional casing, valve chamber, and a ball with a passage extending through it which rotates between an open position with the passage alined with the inlet and outlet openings of the valve casing and a closed position where the passage is out of alinement with the openings, which ball cooperates with a sealing ring mounted around one of the openings. Infringement rests on whether the Electric Boat sealing ring and/or the Worcester sealing ring are within the scope of claims 7 and 8 of the patent in suit.

The Electric Boat sealing ring has an outer body portion and an inner portion which is of reduced cross sectional area and which projects inwardly toward the axis of the ring and contacts the ball. This inner portion is shaped in the form of a projecting edge or lip which increases in thickness outward in the radial direction of the ring as required by patent claim 7. Although the portion of the Electric Boat sealing ring designated as the lip has surfaces of differing inclinations, the faces of the lip, one disposed toward the ball and the other away from the ball, diverge substantially uniformly outward in the radial direction as required by patent claim 8. The issue is whether the lip is free to bend in the axial direction of the sealing ring. Defendant argues that the Electric Boat sealing ring does not function substantially the same way to obtain the same result but instead torsionally twists by the ball pressing on the lip to rotate the entire sealing ring about a circular line representing the locus of points which are the centroids of the cross sections of the sealing ring. It is obvious, however, that the inner portion of the Electric Boat sealing ring is of reduced cross section due to its tapered cross sectional shape and that there will also be lip bending sealing in the Electric Boat ball valve. Tests conducted on the Electric Boat sealing ring demonstrated that there were *both* substantial torsional twisting and substantial lip bending. The torsional twisting is additive in nature and is not exclusive of the lip bending defined in patent claims 7 and 8. The Electric Boat ball valve responds to claims 7 and 8 of the patent in suit and performs substantially the same function to obtain substantially the same result. The accused Electric Boat ball valve infringes patent claims 7 and 8.

With regard to the accused Worcester ball valve sealing ring, the major issue is whether this sealing ring has the lip configuration defined by claims 7 and 8. The Worcester sealing ring has an inner axial surface which is a spherical portion having a radius greater than that of the ball. The inner radial portion of the sealing ring is reduced in cross sectional area and tapers outward in the radial direction due to the spherical axial inner surface, a flat cylindrical axial outer surface, and the parallel flat front and rear faces. When the sealing rings are mounted in the valve chamber about each of the inlet and outlet openings, the distance between the rings is less than the diameter of the ball so that the ball preloads the inner radial tapered portion of the sealing ring by contacting approximately 50 percent of the axial inner spherical portion. As the ball is moved by fluid pressure downstream, the ball bends a portion of the tapered portion and compresses a portion of the sealing ring so that the area of contact increases from 50 percent up to 100 percent of the inner spherical surface as the pressure increases. The Worcester ball valve sealing ring combines lip bending with a progressive compression sealing between the ball and the seat. This progressive compression sealing is additive in nature and not exclusive of the lip-bending concept defined in claims 7 and 8 of the patent in suit. The tapered portion of the Worcester ball valve sealing ring functions in substantially the same way to produce substantially the same result as the lip defined in claims 7 and 8. The Worcester ball valve infringes patent claims 7 and 8.

Both of the accused ball valves include sealing rings in which grooves are provided in their outer peripheral edges to permit fluid to escape through the sealing ring on the upstream side of the valve. Defendant argues that the accused ball valves do not infringe claims 7 and 8 of the patent in suit because the prosecution history limits the claims to a ball valve having lip sealing on the upstream side. The prosecution history does not so limit the clear intent of claims 7 and 8 to define either an upstream sealing ring or a downstream sealing ring.

COLAIANNI, *Trial Judge:* On May 16, 1967, Commissioner Donald E. Lane [1] rendered an opinion,[2] proposed findings of fact, and a recommended conclusion of law in which he concluded that claims 7 and 8 of plaintiff's United States Letters Patent No. 2,945,666 (hereinafter referred to as the '666 patent) were valid and infringed by defendant's unauthorized use of ball valves manufactured by the Electric Boat Division of General Dynamics Corp. and Worcester Valve Co., Inc.[3] However, prior to final action, plaintiff's ownership of the patent in suit was put in issue by E. W. Bliss Co., an intervenor in an infringement action in the United States District Court for the District of Massachusetts between Jamesbury Corp. as plaintiff and Worcester Valve Co., Inc., as defendant. In view of the Massachusetts suit, the parties agreed to a stay of proceedings in the present suit, after the commissioner's report had been filed, until ownership of the patent in suit had been settled in the Massachusetts court.

On June 29, 1971, plaintiff reported to this court that following a full trial on the issue of ownership, the United States District Court for the District of Massachusetts entered judgment for Jamesbury Corp., 318 F. Supp. 1 (1970). Plaintiff further reported that the District Court's judgment had been affirmed by the United States Court of Appeals for the First Circuit, 443 F. 2d 205 (1971). At the same time, plaintiff moved to remand the case to the trial division of this court for further proceedings and additional findings of fact concerning an issue raised by E. W. Bliss Co. and commented upon, without deciding, by the Massachusetts District Court, to wit, whether the named inventors of the patent in suit, Howard G. Freeman and Oscar R.

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[1] Now Judge of the United States Court of Customs and Patent Appeals.

[2] 153 USPQ 672 (Trial Div., Ct. Cl. 1967).

[3] This opinion is supplemental to that of May 16, 1967, and a thorough understanding of the facts requires a careful review of former Commissioner Lane's prior opinion. Moreover, because of this relationship, the findings of fact in this report begin with No. 26 and depend upon the findings in the earlier report.

Vaudreuil, were joined in a manner irremediably contrary to applicable law. Thus, at 318 F. Supp. 6, in fn. 6, the District Court in Massachusetts stated:

> If relevant, the court would find that Vaudreuil was added to the application as a spurious joint inventor to shield Jamesbury against any claim by Rockwood that its president and principal shareholder had conceived the invention while a Rockwood employee.

On appeal, the First Circuit noted this finding and Jamesbury's strenuous objection that it was erroneous. The decision of the First Circuit indicated that the finding was clearly dictum and not binding in other litigation, but because it felt that there was evidence to support it, the court concluded that the finding could not be said to be clearly erroneous.

In addition, plaintiff moved to remand this case back to this court's trial division so that additional findings of fact could be made concerning a patent called to plaintiff's attention by Worcester Valve Co., defendant in the Massachusetts action, during the settlement discussions between the parties. The patent, Melichar, *et al.*, United States Patent No. 2,409,220 (hereinafter referred to as the '200 patent) was, according to plaintiff's remand motion, alleged by Worcester Valve Co. to constitute a reference highly pertinent to the validity of the patent in suit. Although defendant opposed plaintiff's motion to remand, this court, in an order dated October 1, 1971, remanded this suit to allow defendant to raise in supplemental pleadings the issues of misjoinder of inventors and the effect of Melichar, *et al.*, on the validity of the claims in suit.[4]

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[4] More exactly, the order stated in pertinent part:

"(1) defendant shall have 45 days from this date within which to file a supplemental answer, setting forth such defenses as it may wish to present on the question as to whether the inventors of the patent in suit are joined together in a manner irremediably contrary to applicable law, plus such defenses as it may wish to present pursuant to 28 [35] U.S. Code §§ 102 and 103, as to the effect of the Melichar patent on the validity of the patent in suit.

"(2) Plaintiff shall have 30 days after the filing of defendant's supplemental answer within which to file plaintiff's responsive pleading.

"(3) The case is remanded to a trial commissioner for a trial and report of his findings of fact and conclusions of law on the issues that may be raised by such supplemental pleadings, and

"(4) Defendant's motion to retry the issues of fact and law previously tried before and reported by a commissioner of this court is denied."

In accordance with said order, an additional trial was conducted. The issues at trial were limited to whether:

> (1) there was a misjoinder of inventors in the patent in suit because Freeman was the sole inventor of all subject matter contained and claimed therein;
>
> (2) Vaudreuil was added as a coinventor without error and with deceptive intent in order to deceive Rockwood, Freeman's former employer, into believing that the invention claimed in the patent was developed when Freeman started working with Vaudreuil, after he left Rockwood's employ, and
>
> (3) the prior art patents of Melichar, *et al.*, and Cross British Specification No. 373,660 render the claims in suit unpatentable.

As a result of a careful and complete evaluation of each of defendant's contentions, and for reasons which will be explained in considerable detail hereinbelow, it is concluded that claims 7 and 8 of the '666 patent are valid and infringed by defendant's unauthorized use of ball valves manufactured by the Electric Boat Division of General Dynamics Corp. and the Worcester Valve Co., Inc.

## *Background*

Howard G. Freeman obtained a bachelor of science degree in mechanical engineering from Worcester Polytechnical Institute in June of 1940. Upon graduation, he was hired by the Rockwood Sprinkler Co. (hereinafter referred to as "Rockwood") of Worcester, Mass. He was later named director of research, and held that position until January of 1954.

On August 28, 1940, which was shortly after he began his employment at Rockwood, Freeman executed an employment agreement. The agreement provided in pertinent part that Freeman was—

> * * * to give to Rockwood the full benefit and enjoyment of any and all inventions or improvements which he may make while in the employ of Rockwood * * * and all inventions which are made or worked out on the time and at the expense of Rockwood. * * *
>
> Said Freeman further agrees that he will without additional consideration disclose promptly to Rockwood all of the above-described inventions or improvements * * *.

During the course of his employment at Rockwood, some 19 United States patents, as well as the foreign counterparts of these United States patents, naming Freeman as inventor or coinventor, were issued by the United States Patent Office. Freeman agreed to the assignment of all of his rights, title and interest in each of these patents to Rockwood.

As part of his duties as director of research, Freeman was primarily responsible for designing and improving all of Rockwood's products. He also had full authority, without the prior approval of any other company official, to submit ideas which he believed to be novel to Rockwood's patent attorneys.

In turn, for his contributions, Freeman was included in Rockwood's "key man" program under which company executives received bonuses based upon Rockwood's earnings. At the time of his departure in 1954, Freeman's compensation, including bonuses, was about $25,000 annually.

While Rockwood's product line varied somewhat over the years, by the latter part of 1953 its principal products were sprinkler systems, fire fighting equipment, rescue equipment for airports, and ball valves. In 1953, ball valves constituted about 8 to 10 percent of Rockwood's total annual sales.

Rockwood manufactured single seat compression-type ball valves while Freeman was employed there. This type of ball valve utilized a seat on only one side of the ball. Since, in the operation of these valves, the ball was jammed by a spring or other device against an opposing seat and formed a compression seal, the valve seat was referred to as a "jam seat." While commercially successful, this type of ball valve had the disadvantage of only being able to control the flow of fluid adequately in one direction. Also, the "jam seats" on some valves would swell and cause the valves to leak. The swelling of a "jam seat" would also make a valve difficult to operate.

Beginning about 1945, Rockwood customers occasionally requested a ball valve which would be capable of controlling the flow of fluid through it in either direction. However, such a valve was never manufactured by Rockwood while Freeman was its director of research.

In the fall of 1953, while still director of research, Freeman became somewhat dissatisfied with his employment at Rockwood and discussed the possibility of going into the ball valve manufacturing business with a personal friend, Saul Reck. It was contemplated that Reck would manage the financial aspects of the new business and Freeman would contribute his engineering and design talents. After a number of meetings, Reck, who in the past had financed several new business ventures, obtained commitments of about $60,000 from several potential investors. The investors were apparently willing to take a chance with this new business venture on the understanding that there was a good market for ball valves.

On January 13, 1954, Freeman met with William J. Carroll, Rockwood's president, to express his dissatisfaction with his compensation and status at Rockwood. Freeman indicated that he would resign if something was not done. Freeman was told that he would be given an answer shortly. Failing to hear from Mr. Carroll by January 20, 1954, Freeman sent him a letter of resignation suggesting that his effective resignation date be January 30, 1954. Freeman's letter also indicated a willingness to serve an additional reasonable period or to have his resignation take effect sooner at Rockwood's option. On January 25, 1954, Mr. Carroll met with Freeman, and they agreed that Freeman would leave that afternoon. Freeman's employment and duties at Rockwood ended on that day.

Upon leaving Rockwood on January 25, 1954, Freeman called Mr. Reck and told him to do what was necessary to obtain the financing for the new company which they had earlier discussed. Jamesbury Corporation's Articles of Incorporation were drawn up on January 29, 1954. The contributions by the initial investors were in the form of checks made out to Jamesbury Corp. and postdated February 2, 1954.

On February 1, 1954, Freeman commenced a series of drawings and sketches of valve components. Some were undated, but none were begun before February 1, 1954. It took Freeman several days to complete the drawings and he did not complete any of them in a single day. While drawing and sketching during the first and second week of February, Freeman also began drafting a written description of three ideas he was working on. One of these ideas was for a new valve seat. The written statement describing Freeman's new valve seat was completed before February 23, at which time the written description along with five illustrative sketches were taken to his patent attorney in Boston. The written description read in part:

> The new valve seat has both a flexible sealing surface and a non-flexible surface to absorb compression load. By utilizing the design as shown, the lip seal is precompressed before the ball surface strikes the non-flexible surface. The intent of the design is to maintain a definite space between the seat and the ball to allow for swelling.

On the basis of this meeting, the patent attorney prepared a draft of a patent application containing four claims and a drawing containing four figures. The drawings specifically showed a seal configuration which included a V-notch, substantially as shown in Fig. 5 of finding of fact 36, to provide for greater flexibility. The claims of the draft application covered this V-notch design. The oath accompanying the draft named Freeman as the sole inventor of the claimed subject matter.

On April 27, 1954, this draft was forwarded to Freeman to review but the trial transcript fails to indicate if Freeman ever signed it or filed it in the United States Patent Office. Accordingly, the draft claims cannot be taken as establishing the metes and bounds of the V-notch seat as envisioned by Mr. Freeman. Indeed, the most that can be said of them is that they set forth the patent attorney's understanding of what Mr. Freeman had invented.

In the latter part of March 1954, Freeman set up a lathe in space he had rented in Worcester, Mass., and started to make parts for his new valve. Shortly thereafter, he also set up apparatus to test the prototype valves he had made. Freeman's initial efforts at producing a workable valve were unsuccessful and he continued to experiment with various modifications of his original V-notch design. He was particularly concerned about the valve seats tearing after only a few operations of a valve, but he was unable to successfully find a solution to this design defect.

Oscar Vaudreuil, since deceased, owned a machine shop in Worcester, Mass., which supplied Jamesbury Corp. with parts and services during 1954. Since Jamesbury Corp. had little cash to pay for these goods and services, Vaudreuil accepted stock in the corporation in lieu of money. Vaudreuil observed some of the tests being performed by Freeman. In order to overcome the seat tearing problem which Freeman's design was experiencing, Vaudreuil suggested that a small part of the metal casing behind the flexible valve seat be chamfered or cut away. This part of the metal casing is represented by 44 in Fig. 9 of the '666 patent (*see* finding 38). Adoption of the suggestion resulted in a valve seat that was free of the tearing defect that had plagued Freeman's earlier design.

An analysis of Vaudreuil's suggestion led Freeman to conclude that the chamfer provided lip flexibility, and that this necessary lip flexibility could also be obtained by cutting away one of the two lips of his V-notch valve seat instead of the more expensive and difficult chamfering of the metal casing. This modification of the valve seat was further refined into the design shown in Fig. 5 of the patent in suit (*see* finding 10).

In may 1954, Freeman returned to his patent attorney in Boston and described the changes that he and Vaudreuil had made to the valve. Freeman asked the patent attorney whether Vaudreuil was to be considered a coinventor and was told that he was.[5]

Plaintiff's attorney revised the previously prepared draft application. This revised draft was later filed as Patent Application Serial No. 436,188 (hereinafter referred to as the '188 application) by including therein the design change suggested by Vaudreuil as well as Freeman's modification thereof. More specifically, Fig. 8 of the application incorporates the chamfer which Vaudreuil had suggested while Fig. 7 shows an equivalent modification that resulted by Freeman's removal of one of the two lips of the original V-notch valve seat without chamfering the abutting casing.

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[5] Defendant's contention, that plaintiff's failure to call the attorney as a witness gives rise to a presumption that the attorney's testimony would have been detrimental to plaintiff, is found to be unpersuasive. During pretrial discovery, the attorney was deposed by defendant. Moreover, defendant could have called the attorney as a witness at trial if it so desired. Under these circumstances, it is impossible to presume that the attorney's testimony would have favored defendant and been detrimental to plaintiff.

### *Misjoinder*

While it is true that the inclusion of more or less than the true inventors in a patent renders it void, *Iowa State University Research Foundation, Inc.* v. *Sperry Rand Corp.*, 444 F. 2d 406, 408, 170 USPQ 374 (4th Cir. 1971), there is a presumption that the inventors named in an issued patent are correct. *Acme Highway Products Corp.* v. *D. S. Brown Co.*, 431 F. 2d 1074, 167 USPQ 129 (1970 6th Cir.), *cert. denied*, 401 U.S. 956 (1971); *Mueller Brass Co.* v. *Reading Industries*, 352 F. Supp. 1357, 176 USPQ 361 (E.D. Pa. 1972), *aff'd*, 180 USPQ 547 (3d Cir. 1973). Thus, it is well established in this court that since misjoinder is a technical defense, it must be proven by "clear and convincing" evidence. *Garrett Corp.* v. *United States*, 190 Ct. Cl. 858, 422 F. 2d 874, 164 USPQ 521, *cert denied*, 400 U.S. 951, 167 USPQ 705 (1970). This is the law in other courts as well. *Acme Highway Products Corp.* v. *D. S. Brown Co.*, *supra; Stein* v. *Biocoustics, Inc.*, 177 USPQ 680 (D. D.C. 1973); *Congoleum Industries, Inc.* v. *Armstrong Cork Co.*, 339 F. Supp. 1036, 173 USPQ 147 (E.D. Pa. 1972).

In the present case the threshold issue to be decided with respect to misjoinder is whether defendant has demonstrated, by clear and convincing evidence, that Vaudreuil did not make a significant enough contribution to Freeman's original V-notch to make Vaudreuil a coinventor of the subject matter of the claims in suit. As will hereinafter be explained, the evidence of record dictates that defendant has not so demonstrated.

The requirements of joint inventorship were stated in *Monsanto Co.* v. *Kamp*, 269 F. Supp. 818, 824 (D. D.C. 1967):

> A joint invention is the product of collaboration of the inventive endeavors of two or more persons working toward the same end and producing an invention by their aggregate efforts. To constitute a joint invention, it is necessary that each of the inventors work on the same

> subject matter and make some contribution to the inventive thought and to the final result. Each needs to perform but a part of the task if an invention emerges from all of the steps taken together. It is not necessary that the entire inventive concept should occur to each of the joint inventors, or that the two should physically work on the project together. One may take a step at one time, the other an approach at different times. One may do more of the experimental work while the other makes suggestions from time to time. The fact that each of the inventors plays a different role and that the contribution of one may not be as great as that of another, does not detract from the fact that the invention is joint, if each makes some original contribution, though partial, to the final solution of the problem.

The court went on, quoting from *DeLaski & Thropp Circular Woven Tire Co.* v. *Wm. R. Thropp & Sons Co.*, 218 F. 458, 464 (D. N.J. 1914), *aff'd*, 226 F. 941 (3d Cir. 1915), to explain:

> In order to constitute two persons joint inventors, it is not necesary that exactly the same idea should have occurred to each at the same time, and that they should work out together the embodiment of that idea in a perfected machine. The conception of the entire device may be due to one, but if the other makes suggestions of practical value, which assisted in working out the main idea and making it operative, or contributes an independent part of the entire invention, which is united with the parts produced by the other and creates the whole, he is a joint inventor, even though his contribution be of comparatively minor importance and merely the application of an old idea.

The difficulty experienced in attempting to define a standard to be used to determine who is a joint inventor and the type of contribution that is necessary to qualify as a co-inventor is adequately illustrated in *Mueller Brass Co.* v. *Reading Industries*, *supra*, 352 F. Supp. at 1372, 176 USPQ at 372:

> The exact parameters of what constitutes joint inventorship are quite difficult to define. It is one of the muddiest concepts in the muddy metaphysics of the patent law. On the one hand, it is reasonably clear that a person who has merely followed instructions of another in performing experiments is not a co-inventor of the object to

> which those experiments are directed. To claim inventorship is to claim at least some role in the final conception of that which is sought to be patented. Perhaps one need not be able to point to a specific component as one's sole idea, but one must be able to say that without his contribution to the final conception, it would have been less—less efficient, less simple, less economical, less something of benefit.

Moreover, it is necessary, as the court in *Mueller Brass Co.* v. *Reading Industries*, *supra*, 352 F. Supp. at 1373, 176 USPQ at 372, recognized, to also consider the doctrine of "mere suggestions" which—

> * * * denies co-inventorship status to a person who suggests some way to improve an invention casually but takes no further role in fitting the rough suggestion into the scheme of the invention workably. *See Forgie* v. *Oilwell Supply Co.*, 58 F. 871 (3rd Cir. 1893).

The facts in the present case require the conclusion that Vaudreuil did make a contribution of very substantial importance to Freeman. In fact, before Vaudreuil made his contribution Freeman's valve proved to be marginally operable at best with the seats tearing after the ball of a valve had been turned only a few times. However, as a result of Vaudreuil's contribution, tearing of the valve seat was eliminated and plaintiff eventually produced a valve that gained widespread use and substantial commercial success. The facts demonstrate that Vaudreuil's contribution was of crucial importance to Freeman and that Vaudreuil must be considered a coinventor of the valves which incorporated his concept.

Since it is concluded that Vaudreuil did make a substantial contribution to the valve seat embodiments which followed Freeman's unworkable V-notch design, the next question requiring attention is whether the claims in suit cover only the joint invention. Defendant contends that the claims in suit not only cover the joint invention, but they cover as well the original Freeman invention. If the former is true, then there is no misjoinder. On the other hand, if the latter is found to be true, there is misjoinder. In any event, in order to properly resolve this issue, it becomes necessary to establish the scope of claims 7 and 8. In *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502, 510 (1917), the Supreme Court stated that: "The scope of every patent is limited to the invention described in the claims contained in it, read in the light of the specification." More recently, the Supreme Court reiterated that position in *United States* v. *Adams*, 383 U.S. 39, 49, 148 USPQ 479, 482 (1966), when it stated: "* * * it is fundamental that claims are to be construed in the light of the specifications and both are to be read with a view to ascertaining the invention." *See also Tate Engineering, Inc.* v. *United States*, 201 Ct. Cl. 711, 719, 477 F. 2d 1336, 1340 (1973).

The Supreme Court has also stated that "* * * an invention is to be construed not only in light of the claims, but also with reference to the file wrapper or prosecution history in the Patent Office." *Graham* v. *John Deere Co.*, 383 U.S. 1, 33, 148 USPQ 459, 473 (1966). This direction has been followed by a number of courts, including: *Ellipse Corp.* v. *Ford Motor Co.*, 452 F. 2d 163, 171 USPQ 513 (7th Cir. 1971), *cert denied*, 406 U.S. 948 (1972); *Waldon, Inc.* v. *Alexander Mfg. Co.*, 423 F. 2d 91, 165 USPQ 46 (5th Cir. 1970). Indeed, this court's own pronouncement in *Autogiro Co. of America* v. *United States*, 181 Ct. Cl. 55, 384 F. 2d 391, 155 USPQ 697 (1967), stresses that the claims of a patent are necessarily construed in connection with the other parts of the patent instrument, as well as the circumstances surrounding the prosecution of the patent application through the Patent Office.

An analysis of the 10 claims contained in the originally filed '188 application indicates that claims 1 through 8 were sufficiently generic to read on the original Freeman valve design, as well as upon the Freeman-Vaudreuil joint invention. Claims 9 and 10 only covered embodiments which were jointly invented by Freeman and Vaudreuil, and did not read on the Freeman V-notch. The '188 application was filed in the joint names of Freeman and Vaudreuil on June 11, 1954.

As a result of a first amendment to the '188 application, Freeman and Vaudreuil canceled claims 6, 7, and 8 of the original 10 claims. By a second amendment, claims 1–5, 9 and 10 were canceled and new claims 11–13 added. As explained in the remarks accompanying the amendment, "Claim 11 corresponds in substance to Claim 10 * * *." Claim 10, as hereinbefore stated, originally read only on the joint Freeman-Vaudreuil invention. Similarly, since new claims 12 and 13 were dependent upon new claim 11, there can be no doubt that the joint inventors ultimately limited all of the claims in that application to the joint invention.

On February 14, 1958, the joint inventors filed a continuation-in-part application, Serial No. 715,372 (hereinafter referred to as the '372 application) with the Patent Office. The drawings of this application illustrated only the joint Freeman-Vaudreuil invention, and did not illustrate the original Freeman V-notch. Specifically, Figs. 5 and 6 of the '188 application, which illustrated the Freeman V-notch design, were not included in the '372 application. In addition, Figs. 2 and 4 of the '188 application were modified by eliminating the Freeman V-notch seat and substituting therefor the joint Freeman-Vaudreuil seat. Furthermore, new Figs. 5–7, depicting only the joint invention, were added.

The specification of the '188 application was extensively revised and its entire emphasis changed. The new specification dealt almost exclusively with the joint invention while relegating the V-notch to a four sentence discussion. Furthermore, as a result of the use of the term "free standing lip" in each of the 10 claims filed with the application, all claims read only on the joint invention and not on the Freeman V-notch.

In response to a Patent Office rejection of the '372 application over the parent '188 application, the '188 application was abandoned.

By subsequent amendment, applicants presented new claim 14 to the Patent Office. This claim, which eventually matured into claim 7 of the patent in suit, did not contain the term "free standing lip" and hence might be construed, if viewed in the abstract, as reading on the Freeman V-notch design. However, it is clear from the prosecution history that there was no intent on the part of Freeman and Vaudreuil to broaden the coverage of claims 7 and 8 by the elimination of the term "free standing lip." Certainly, the acts of the applicants in prosecuting both the '188 and the '372 application in the Patent Office dictate against any intent on the part of the joint inventors to cover the V-notch design by claims 7 and 8.

Specifically, since the applicants had narrowed the claims in their parent '188 application, and, as well, restricted all of the original 10 claims in the '372 application, in view of prior art cited by the Patent Office to exclude the Freeman V-notch design, it would be improper to permit them, by way of the later submitted claim 14 in the '372 continuation-in-part application, to recapture subject matter that they had willingly relinquished. To do so would ignore the well-established doctrine of "file wrapper estoppel" which does not allow recapture of relinquished subject matter under circumstances present in this case *Exhibit Supply Co.* v. *Ace Patents Corp.*, 315 U.S. 126, 52 USPQ 275 (1942); *Hughes Tool Co.* v. *Varel Manufacturing Co.*, 336 F. 2d 61, 142 USPQ 407 (5th Cir. 1964).

Thus, it must be concluded that Vaudreuil is properly considered to be a coinventor with Freeman of the invention disclosed by claims 7 and 8 of the patent in suit, and that these claims do not cover the Freeman V-notch valve seat. Thus, there is no misjoinder of inventors present in this case.

### *Validity*

In addition to its defense of misjoinder, defendant also contends that the '666 patent is invalid. In support of its contention of invalidity, defendant, at the latest trial, relied on the Melichar, *et al.*, and Cross patents. Title 35 U.S.C. § 282 provides that a patent is presumed to be valid and the burden of establishing invalidity rests upon the party asserting it. However, numerous courts have concluded that the failure of the Patent Office to consider important prior art references during its evaluation of the pending application is enough to overcome the statutory presumption of validity of an issued patent. *See T. P. Laboratories* v. *Huge*, 371 F. 2d 231, 151 USPQ 605 (7th Cir. 1966).

Defendant contends that claims 7 and 8 of the '666 patent are invalid by reason of their failure to meet the requirements of patentability set forth in 35 U.S.C. § 103.[6] In *Graham* v. *John Deere Co.*, 383 U.S. 1, 148 USPQ 459 (1966), the Supreme Court indicated that an analysis of the following factors is required in resolving whether or not a patent meets the requirements of patentability set forth in 35 U.S.C. § 103 —

(1) the scope and content of the prior art;
(2) the difference between the prior art and the claims in issue; and

(3) the level of ordinary skill in the pertinent art.

Secondary considerations, such as commercial success, satisfying a long-felt need, and the failure of others, are also relevant considerations in evaluating patentability under 35 U.S.C. § 103.

The above factual determinations must be made without resorting to the teaching of the patent at bar or the deceptive and oftentimes unwitting use of hindsight. *See Garrett Corp.* v. *United States*, 190 Ct. Cl. 858, 422 F. 2d 874, 164 USPQ 521 (1970), *cert. denied*, 400 U.S. 951, 167 USPQ 705 (1970).

For reasons which follow, it is concluded that neither the Melichar, *et al.*, nor Cross patents, considered individually or in combination, disclose a ball valve having a sealing ring with the structure and functional features required to perform the intended purposes of the ball valve defined by claims 7 and 8 of the '666 patent.

As explained in considerable detail in the findings, neither of the prior art patents deal with valves that control the flow of fluid in both directions through a ball. Neither Melichar, *et al.*, nor the Cross patents were concerned with a valve that was capable of controlling fluid passage through an apertured ball by a quarter turn of said ball. Accordingly, no attention was given, and no structure provided, to insure against the flexible lip of either Cross or Melichar, *et al.*, being lodged into the fluid port of an apertured ball valve such as used by the patented structure in suit.

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[6] 35 U.S.C. § 103 provides:

"A patent may not be obtained though the invention is not identically disclosed or described as set forth in section 102 of this title, if the differences between the subject matter sought to be patented and the prior art are such that the subject matter as a whole would have been obvious at the time the invention was made to a person having ordinary skill in the art to which said subject matter pertains. Patentability shall not be negatived by the manner in which the invention was made."

The lodging of the lip into the fluid port would not only prevent the valve from being able to be completely turned into its on or off positions, but could result in complete inoperativeness of the valve if the lip were cut off in the movement of the ball valve between its open and closed conditions.

Moreover, neither of the prior art references teach the use of a lip seal or seals to totally support a ball valve in the manner disclosed by the Freeman-Vaudreuil patent. In addition, neither Cross nor Melichar, *et al.*, disclose a lip which has a tapered cross-sectional shape in its radial direction to give the lip graduated stiffness, and, at the same time, provide a support surface for a ball valve over and above that initially provided by the lip that is subjected to additional fluid pressure when the ball valve is in its closed position.

Finally, neither Cross nor Melichar, *et al.*, were concerned with and thus failed to provide the necessary structure, as the '666 patent did, to solve the problems of temperature variation, pressure variation and valve wear, or to compensate for swelling of the valve seats.

Defendant also contends, in the event the court finds that there has been no misjoinder, that the subject matter of claims 7 and 8 of the patent in suit is obvious over the Freeman V-notch design. Although plaintiff questions whether the Freeman V-notch can be used as prior art against the joint invention covered by claims 7 and 8, the following cases support defendant's position: *In re Bass*, 474 F. 2d 1276, 177 USPQ 178 (CCPA 1973); *Sutter Products Co.* v. *Pettibone Mulliken Corp.*, 428 F. 2d 639, 166 USPQ 100 (7th Cir. 1970); *Grinnell Corp.* v. *Virginia Electric & Power Co.*, 277 F. Supp. 507, 156 USPQ 443 (E.D. Va. 1967).

However, after a careful review of the facts hereinbefore stated, and from a review of the entire trial record, it must be concluded that defendant has failed to show that it would be obvious to one of ordinary skill in the art to modify the Freeman V-notch either by cutting a chamfer in the casing or by removal of the lip adjacent to the casing. In fact, the surprisingly superior results obtained when Vaudreuil's contribution was effected speak to the nonobviousness of it. *United States* v. *Adams*, *supra*. Thus, upon incorporation of the Vaudreuil contribution into the valve, an inoperable device was changed into a commercially successful product. The unexpected superiority obtained by modifying the Freeman V-notch as plaintiffs did belies defendant's contention and it, therefore, must be concluded that claims 7 and 8 of the patent in suit are unobvious over the original Freeman V-notch design.

In conclusion, it is specifically found that claims 7 and 8 define a patentable invention which was jointly invented by Messrs. Freeman and Vaudreuil, and that the invention defined by said claims would not have been obvious to a person of ordinary skill in the art at the time that the joint invention was made.

## FINDINGS OF FACT*

1. This is a patent suit under the provisions of Title 28 U.S.C. § 1498, filed July 10, 1963, to recover reasonable and entire compensation for the unauthorized use and manufacture by or for the United States of the plaintiff's patented invention described and claimed in United States Letters Patent No. 2,945,666, entitled "Ball Valve." A first amended and supplemental petition was filed June 2, 1965. Specifically, the plaintiff charges that the defendant has used ball valves manufactured by Electric Boat Division, General Dynamics Corp., and by Worcester Valve Co., Inc., and that such use infringes claims 7 and 8 of said patent. The application for patent was filed February 14, 1958, and was stated to be a continuation-in-part of copending application filed June 11, 1954. The patent in suit was issued on July 19, 1960, to the plaintiff.

2. Plaintiff, Jamesbury Corp., is organized and exists under the laws of the State of Massachusetts, having its principal place of business in Worcester, Massachusetts. Howard G. Freeman, president of Jamesbury, and Oscar R. Vaudreuil are designated coinventors in patent 2,945,666.

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*Findings 1 through 25 were made by (then) Commissioner Lane and 26 through 58 by Trial Judge Colaianni.

3. The subject matter of the patent in suit relates to a valve apparatus for controlling the flow of fluids in a pipeline. The valve described in said patent is of the ball valve type. A ball valve structure comprises a casing adapted to be connected to a pipeline and having a valve chamber as well as inlet and outlet openings communicating with that chamber. A ball is mounted in said chamber, and is provided with a passage extending therethrough. In one position of rotation the passage in the ball is alined with openings in the valve casing so as to permit fluid flow through the apparatus. In another position of rotation the passage in the ball is positioned at right angles to the openings in the valve casing so as to prevent flow of fluid through the apparatus. Sealing rings are provided with the casing on either side of the ball closure in order to make the apparatus leakproof when the ball is positioned to prevent fluid flow. Apparatus of this general kind has been known in the patent art for at least 50 years.

4. Prior to plaintiff's patented valve, ball valves were not generally accepted or widely used by industry. Originally, a ball with a passage extending therethrough was tightly journaled into the valve casing. Temperature variations, pressure variations, and/or valve wear, caused the valve to leak or made it extremely difficult to operate the valve by rotating the ball between open and closed positions. Attempts to solve this problem were made in the prior ball valve art by journaling the ball against some sealing material, preferably nonmetallic, in what were known as compression seats. Generally, the ball is truncated on each side where the passage extends through. This resulted in a reduced ball pressure against the seat when the ball is placed so that the passage lines up with the openings in the casing in the open condition. When the valve is closed, the nontruncated portion of the ball presses into the material of the seat with sufficient force to provide a fluid tight seal. A compression seat or seal is one which is designed so that the ball can, under pressure, press into the seat material sufficient to provide a fluid tight seal, the area of contact being determined primarily by the compressibility of the seat material. Such compression seats make no provision for expansion and contraction of the ball or casing and

for valve wear. These attempts did compensate somewhat for the problems of leakability and ease of ball rotation but not adequately for use in high-pressure installations.

5. The Jamesbury ball valve construction which is the subject matter of the patent in suit solved the problems of temperature variation, pressure variation, and valve wear. The patented ball valve employs a sealing ring utilizing a principle different from the compression seat or sealing ring in which the ball presses *into* the material of the sealing ring. The Jamesbury sealing ring has a portion known as a lip which flexes or bends with respect to the remainder of the sealing ring. The lip projects inward and has a graduated stiffness due to tapered cross sectional shape in the radial direction. The lip is prestressed which causes it to flex into sealing contact or engagement with the ball at all times, even when the ball is being rotated.

6. After the Jamesbury valve was first described in several trade journals, over 1,000 inquiries were received and many later became orders for the purchase of the patented valve. This flow of inquiries and orders grew so fast that Jamesbury could not keep up with production orders. Jamesbury grew from a corporation having 3 or 4 employees at the time of the announcement in the trade journals in 1954 to over 550 employees at the time of trial on the merits in January 1966. Over 3 million Jamesbury ball valves valued at over $50 million have been sold since the trade journal announcement in 1954. Problems were solved in nonmilitary applications, in the synthetic rubber field, and in the handling of dangerous gases or chlorine.

7. The increased size and better construction of the hull of the modern submarine, including the nuclear submarine, enables the submarine to navigate now at much greater depths than heretofore. The operation of submarines at greater depths caused problems. Valves have to operate under great pressures, must be able to withstand the increased hydraulic shock caused by depth charges, and must permit fluids to flow silently. Prior valves used on submarines were generally of the Globe type which operate like a faucet and often make considerable noise. There were problems of corrosion and erosion with sea water in submarines and with the fact that the

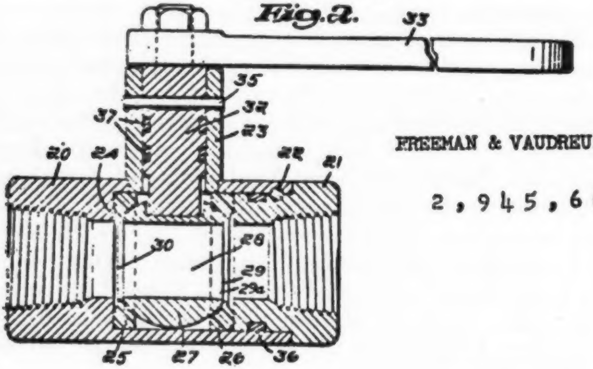
valves had to be remotely operated. Other Navy requirements could not be revealed due to security restrictions which hampered valve suppliers by not revealing the entire fluid system of the submarine for which the valves were to be supplied. Discussions could deal only with the valve constuction itself.

**8.** In the summer or early fall of 1957, an engineer from defendant's Portsmouth Navy Yard contacted Jamesbury Corp. about the possible use of the Jamesbury ball valve on Navy submarines. At the request of the Portsmouth Navy Yard, Jamesbury turned its ball valve design and test results over to the Electric Boat Division of the General Dynamics Corporation which was then building nuclear submarines. At that time Electric Boat had no ball valves or even contemplated using ball valves. Jamesbury Corp. engineers lectured to Electric Boat engineers on the theory and function of ball valves. Jamesbury sold some ball valves to Electric Boat. In April 1958, Electric Boat informed Jamesbury Corp. that they intended to make their own ball valves and no longer needed Jamesbury.

**9.** No valve in previous submarine service met the strategic and operating valve needs of the modern submarine except the Jamesbury ball valve. Jamesbury ball valves were used successfully on at least three submarines. The valves met all of the Navy requirements. Some valves failed in actual use and were redesigned to overcome the problem of swelling due to expansion in sea water by cutting away the outer diameter of the Jamesbury seal. The redesigned ball valve was successful. Defendant's contention that the Jamesbury valve was redesigned to incorporate torsional twisting is without merit.

**10.** The Freeman, et al., patent in suit states that one of its objects is to provide a valve seat construction which provides maximum security against leakage, which reduces wear and insures smooth opening and closing of the valve, and also provides a construction which is adapted for the manufacture of valve seats from hard plastics or metals or flexible rubber-like materials. Figures 2, 5, 6, and 7 of the patent drawings are reproduced herein. The patent discloses a ball valve comprising a casing including fittings 20 and 21 and a bonnet 23. The interior of the casing is provided with a valve chamber

Fig. 2.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FREEMAN & VAUDREUIL

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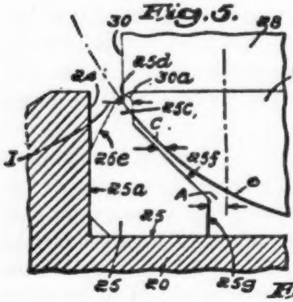
Fig. 5.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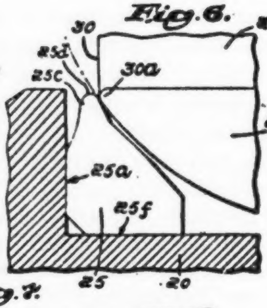
28
25d
30a
24
27
25c
C
I
26e
25f
25a
A
O
25
25
20
25g

Fig. 6.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28
25d
25c
30a
27
25a
25f
25
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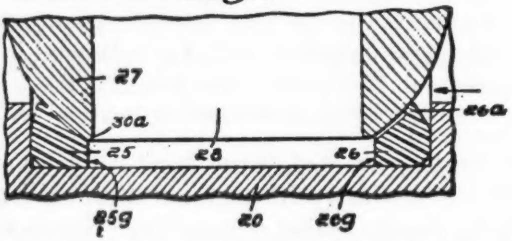
Fig. 7.


27
26a
30a
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28
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25g
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26g

containing sealing rings 25 and 26. A ball 27 is positioned between the sealing rings and is provided with a passage 28 which can be turned to aline with the openings in the fittings 20 and 21 by operation of a handle 33. The operative engagement between the stem 32 and the ball 27 permits slight axial movement of the ball which is thus able to move against the sealing ring 25 or 26 in response to fluid pressure when the valve is closed by turning the handle 33 from the open position illustrated in Fig. 2 to the closed position shown in Fig. 7. The valve seats 25 and 26 are provided with an inwardly extending freestanding tapered portion designated as lip 25c in both Figs. 5 and 6. It is this lip 25c which contacts the surface of the ball 27 to provide a seal between the ball and the fittings. The lip 25c has a rounded inner surface 25d and an oblique surface 25e. Leading to the lip is another oblique surface 25f on which the ball becomes seated when the lip 25c is deflected under load. The patent specification states that there is a limited region of engagement between the ball and the seat and that the tapered portion or lip 25c, because of its shape, has a graduated stiffness against bending. The patent discloses that when the valve is assembled the dimensions of the seats in the ball are chosen so that the tapered portions or lips 25c are deflected by the ball, as illustrated in Fig. 6. This is referred to as "pre-loading" of the valve seats. The specific example of the invention illustrated in Fig. 6 of the drawings shows the oblique surface of the valve seat on the side toward the ball contoured so that there is no contact between this face and the ball in the preloaded condition, and so that upon deflection of the lip portion as a result of increasing fluid pressure being applied by the ball, the ball will contact and be partly supported by this face as illustrated at the left side of Fig. 7. The shape of the sealing rings is such that deflection of the lip 25c beyond a certain point permits additional contact between the ball 27 and the sealing ring 25 for such additional sealing. A ball valve utilizing seats of this kind is self-compensating with respect to wear and temperature changes.

11. Patent claims 7 and 8 are involved in this suit. These claims are reproduced below (indentation added):

*Patent Claim 7*

A ball valve comprising:

a casing adapted to be connected to a pipe line and having a valve chamber and inlet and outlet openings;
a ball mounted in said chamber and having a port;

and a sealing ring mounted in said chamber around one of said openings,

said ring having a lip projecting inward toward the axis of the ring and engaging the ball,
said lip being free to bend in the axial direction of the ring and increasing in thickness outward in the radial direction of the ring, and

said ball being rotatable between an open position in which said port is in register with the opening surrounded by said ring and a closed position.

*Patent Claim 8*

A ball valve as described in claim 7,

said lip having side faces disposed one toward the ball and one away from the ball,
and said faces diverging from each other substantially uniformly outward in the radial direction of the ring.

Said claims read on and are supported by the drawings and specification of the patent in suit.

**12.** Defendant contends that patent claims 7 and 8 are invalid on the ground that they are indefinite and fail to distinctly claim subject matter as required by Title 35 U.S.C. § 112. More particularly, defendant contends that the terms lip, axis, axial, radial, and substantially uniformly, used in the claims are not defined or explained in the patent specification. The lip 25c is fully described and illustrated in the Freeman, et al., patent in suit. The sealing ring lip 25c is described as free standing, as having oblique surface 25e and oblique surface 25f, as being deflected under load, and as having a graduated stiffness because of its shape. The specification states that the inner portion of the lip will tend to bend first. The axis of a ring is definite as is the radial direction of a ring. The patent clearly illustrates the oblique surfaces 25e and 25f in Fig. 5 as diverging substantially uniformly. It is found that the patent and patent claim terminology is definite, distinct, and adequate to enable any person skilled in the valve art to make and use the invention claimed. Defendant's contention as to indefiniteness is without merit.

**13.** In obtaining allowance of patent claims, applicants contended in the Patent Office that claims having the limitation of a sealing ring with a lip which increases in thickness outward in a radial direction were patentable over prior art showing a straight nontapered lip. Applicants urged that fluid pressure on a straight lip would cause the straight lip to bend at an intermediate point and curl away from the valve ball and not provide an upstream seal. Defendant's contention that such argument in the Patent Office limits claims 7 and 8 here in suit to an upstream seal is unsound. The clear language of these two patent claims applies to a sealing ring construction irrespective of whether it is a downstream or an upstream seal. The specification of the patent in suit clearly states that the valve disclosed is symmetrical in design and is intended for use in either direction with either ring 25 or ring 26 on the downstream side.

**14.** Defendant urges that patent claims 7 and 8 are invalid as not novel under 35 U.S.C. 102 and/or as obvious to one skilled in the art under 35 U.S.C. 103 over the disclosures of prior U.S. patent 2,516,947, issued to Blevans in 1950; Australian patent 126,685, of 1946; U.S. patent 2,297,161, issued to Newton in 1942; and U.S. patent 2,762,601, issued to Clade in 1956.

**15.** Defendant argues that claims 7 and 8 of the patent in suit are invalid as lacking novelty over the Saunders British patent 692,085. This British patent was not cited by the examiner in the Patent Office, but corresponds essentially to Saunders French patent 1,018,974 which was cited and considered by the Patent Office. The Saunders ball valve construction includes a casing connected to a pipeline, a valve chamber provided with inlet and outlet openings, and a ball mounted in the chamber. In Saunders, a pair of sealing rings are mounted in the chamber around said inlet and outlet openings, and each of the sealing rings has a lip projecting inward toward the axis of the sealing ring. Claims 7 and 8 of the patent in suit call for the lip to engage the ball. When read in light of the specification and drawings of the patent in suit, the term "engaging the ball" recited in claims 7 and 8 means that the lip contacts the ball with sufficient force to provide a fluid tight seal. The lip of the Saunders sealing ring does not always contact or engage the ball, nor does the Saunders sealing ring lip function in substantially the same way as the lip defined in patent claims 7 and 8. The Saunders flange or lip only sealingly engages the ball 1 on the upstream side when the fluid pressure forces the lip against the ball and never sealingly engages the ball on the downstream side because there is no fluid pressure there to force the lip against the ball. The Saunders sealing ring provides a compression type of seal which depends upon the ball pressing into the material of the ring. The sealing rings of Saunders are substantially triangular in cross section to provide a conical surface which is compressed by the ball to form a fluid tight seal. The lip is provided at the inner portion of each ring and engages the ball on the upstream side when fluid pressure acts against the lip to force it against the ball. The seal of Saunders depends primarily on the contact between the ball and the body of the sealing ring, and the flange or lip sealingly contacts the ball on the upstream side when the fluid pressure increases. Saunders seal lip does not increase in thickness outward in the radial direction as required by patent claim 7 nor does the lip have side faces disposed toward and away from the ball which diverge from each other substantially uniformly outward in the radial direction of the ring as required by patent claim 8. Claims 7 and 8 here in suit are patentable over Saunders British patent 692,085.

**16.** Defendant urges that patent claims 7 and 8 are not patentable since it would have been obvious under 35 U.S.C. 103 to replace the straight-sided lip of the Saunders British patent 692,085 sealing ring with a tapered lip as shown by the Antonelli U.S. patent 2,348,587. Antonelli discloses a seal construction for sealing the space between a housing and a spherical member in a front axle assembly for armored cars. Dual wiping lips on the sealing element are tapered inwardly and are downwardly compressed against a spherical member through a flexible neck portion of reduced cross section by the seal housing. The lips disclosed by Antonelli are not free to bend in the axial direction of the sealing ring as required by patent claims 7 and 8 but are compressed downward and would not seal or stay on a ball if placed about the passage extending through the ball of Saunders. Tapering the sealing lip of Saunders would improve the sealing action of the lip when the lip is under fluid pressure but would not satisfy the requirement of patent claims 7 and 8 that the lip always be in sealing contact or engagement with the ball. Claims 7 and 8 define structure not obvious as a whole by modifying Saunders to utilize the seal element of Antonelli.

**17.** Blevans patent 2,516,947 was not cited by the Patent Office and relates to a valve seat and valve core for high-pressure use. Figures 1, 4, and 5 are reproduced herein. Blevans discloses a valve comprising a housing 10 having an inlet opening 11 and an outlet opening 12. A valve core 13 is mounted in said housing and is provided with a flow passage 14. A metal alloy sealing ring 16 is mounted around the downstream opening 12. Sealing ring 16 is provided with two annuli 20 and 21 and with rubber or plastic packing 23 in an annular groove 19 between the annuli. Each of the annuli 20 and 21 projects inward toward the axis of the sealing ring 16 and is flexible enough to undergo limited deflection in the axial direction of the sealing ring. Such deflection is illustrated in exaggerated form in Fig. 5. Each annulus is tapered in cross section and increases in thickness outward in the radial direction of the sealing ring 16, and each annulus has a face disposed toward the core 13 and a face disposed from the core. The Blevans construction includes mechanism for moving the core 13 axially into and out of engagement with the valve seat ring 16. Blevans states that his invention may be applied to any valve in which the face and seat engage *axially*. Neither the lip 20 nor the lip 21 of Blevans engages the valve core as it is turned from its open to closed position, and the Blevans construction is not concerned with the problem of forming a tight seal between the core and the sealing ring 16 during operation of the valve. The structure defined in patent claims 7 and 8 is novel and unobvious as a whole over the construction disclosed in Blevans patent 2,516,947.

**18.** Australian patent 126,685 was not cited by the Patent Office and discloses a plug cock comprising a casing made up of end portions and a connecting sleeve having a chamber. A rotatable ball having a passage therethrough is mounted in the chamber. A pair of sealing rings is positioned, one around an inlet opening and one around an outlet opening. Each sealing ring is provided with a portion which projects inward toward the axis of the sealing ring and which con-

BLEVANS

2,516,947

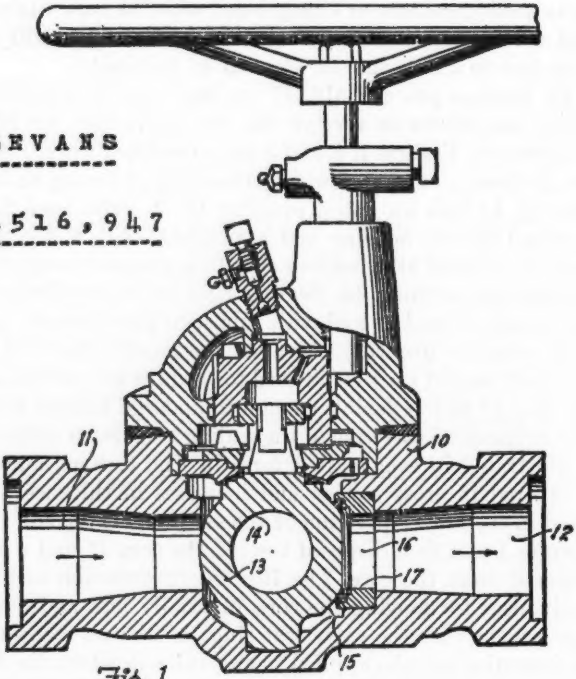
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Fig. 1

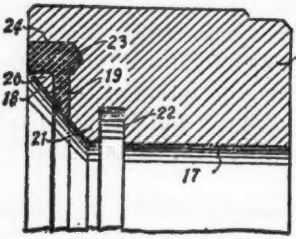
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Fig. 4

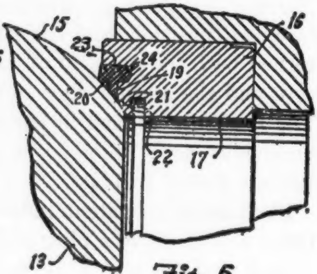
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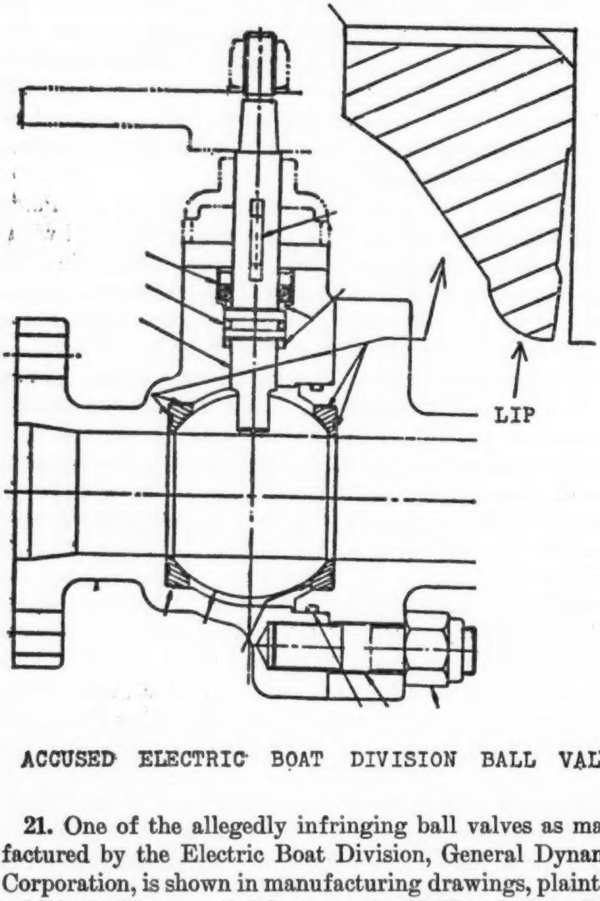
Fig. 5

tacts the ball. The inwardly projecting portions of the sealing rings may be sharp corners or may be chamfered or countersunk for engagement with the ball. Fluid pressure holds the inward portions of the sealing rings against the ball, the latter being mounted in bearing sleeves which prevent axial shifting of the ball under fluid pressure. The Australian patent construction does not provide for axial lip bending or for increasing resistance to such bending. The structure defined in patent claims 7 and 8 is novel and unobvious as a whole over the plug cock construction taught in Australian patent 126,685.

**19.** Newton patent 2,297,161 was not cited by the Patent Office and discloses a valve having a casing provided with a valve chamber in which a ball is mounted for rotation. The casing is provided with an inlet opening and an outlet opening, and the ball is provided with a passage adapted to be positioned in alinement with or transverse to the inlet and outlet openings. Newton discloses saucer-shaped sealing rings. The ball is truncated at each end of the passage and preloads or prestresses the sealing rings during assembly. The sealing rings are further compressed when the increased area of the nontruncated portion of the ball engages the seat material to flatten the rings against the walls of the valve chamber. The Newton valve ball is free to move axially with fluid pressure causing the entire ring to twist and be compressed by the ball. The structure defined in patent claims 7 and 8 is novel and unobvious as a whole over the construction disclosed in Newton patent 2,297,161.

**20.** Clade patent 2,762,601, not cited by the Patent Office, discloses seats for ball valves, the seats being formed of polytetrafluoroethylene and including a seating ring plus an adjacent sealing ring of various cross sections. A single sealing ring of rectangular cross section is shown in one modified construction. Clade also discloses valve stem seals of various shapes. None of the seating and sealing rings disclosed in this Clade patent is provided with a lip projecting inward toward the axis, free to bend in the axial direction, and increasing in thickness outward in the radial direction. In the construction illustrated in Fig. 10 of the Clade drawings, the inward edge of the sealing ring is prevented from bending in the axial direction by a boss on the casing. The structure defined in patent claims 7 and 8 here in suit is novel over and not obvious as a whole from the teachings of Clade patent 2,762,601.



ACCUSED ELECTRIC BOAT DIVISION BALL VALVE

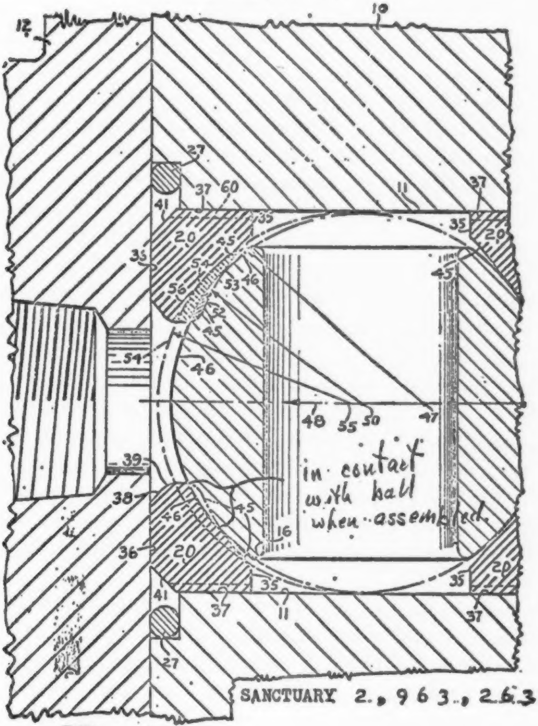
21. One of the allegedly infringing ball valves as manufactured by the Electric Boat Division, General Dynamics Corporation, is shown in manufacturing drawings, plaintiff's exhibit 11. The essential features of said Electric Boat Division ball valve are illustrated in the two figures reproduced herein. Said valve comprises a casing adapted to be connected to a pipeline and having a valve chamber with inlet and outlet openings. A ball is mounted in the chamber and has a port or passage therethrough. A sealing ring is mounted in the chamber surrounding one of the openings. The cross section drawing of the sealing ring shows an outer body portion and an inner body portion, the latter being of reduced cross

sectional area providing a lip which projects inward toward the axis of the ring and which engages the ball. The ball is rotatable between open position in which the port or passage through the ball is in register with the openings and a closed position. The drawing shows that the sealing ring lip has a rounded surface and two faces, one face disposed toward the ball and the other face away from the ball. These faces diverge substantially uniformly outward in the radial direction giving the inner lip portion a greater degree of flexibility than the outer thick portion of the sealing ring. During assembly the sealing ring lip is prestressed or preloaded and maintains a sealing contact with the ball as the latter is turned from an open to its closed position or vice versa. All of the elements recited in patent claims 7 and 8 are present in the accused Electric Boat Division ball valve and function in substantially the same manner to provide substantially the same result during use.

22. The defendant has urged that the construction of the accused Electric Boat Division ball valve is such that the inner lip portion of the sealing ring does not bend materially and that the seal results from "torsionally twisting" the sealing ring, as described in a later Bass, et al., U.S. patent 2,989,990, issued to General Dynamics Corporation in 1961. In torsional twisting, as defined by the Bass patent, the sealing ring is twisted about a circular line representing the loci of points which are the centroids of the cross section of the sealing ring due to the pressure of the ball against the lip of the sealing ring. It is found that the inner portion of the lip of the Electric Boat Division sealing ring has a greater degree of flexibility than the outer portion due to its tapered cross section, and that there is lip bending present in the Electric Boat Division ball valve. Tests conducted on the Electric Boat Division sealing ring at the trial demonstrated that there was both substantial torsional twisting and substantial lip bending. The torsional twisting is additive in nature and is not exclusive of the lip bending defined in patent claims 7 and 8.

23. The second of the allegedly infringing ball valve constructions is identified as the Type P.327, Series 400 manufactured by Worcester Valve Co., Inc., Worcester, Massa-

chusetts. The Worcester valve construction is illustrated in Sanctuary patent 2,963,263 issued in 1960 to Worcester Valve Co., Inc., and by other exhibits. Fig. 4 of the Sanctuary patent drawings and plaintiff's exhibit 20 are reproduced herein to show the accused construction. The Worcester ball valve includes a casing 10 adapted to be connected to a pipeline and having a valve chamber and inlet and outlet openings; a ball mounted in the valve chamber with a port or passage extending therethrough; sealing rings 20 mounted in the valve chamber, one mounted in the chamber about the outlet opening and the other about the inlet opening, the ball being rotatable between an open position in which the port is in register with the openings surrounded by the sealing rings and a closed position. The infringement issue is whether the sealing rings 20 of the Worcester valve have the lip configuration defined by patent claims 7 and 8 of the patent in suit. Each of the Worcester sealing rings 20 has an inner face 45 which is a spherical area having a radius 47 greater than the radius 50 of the ball and a substantially conical face 38 merging with an inner rounded nose portion 39. When the sealing rings 20 are assembled in the Worcester valve chamber about the inlet and outlet openings, the ball bends the tapered nose portion 39 of the sealing ring 20 from the unstressed cross section shown in plaintiff's exhibit 20 to the cross section shown in Fig. 4 of the Sanctuary patent drawings. Under fluid pressure, the ball is moved slightly downstream bending the tapered nose or lip portion 39 and compressing a portion of the ring surface 45. The Worcester sealing ring provides combined lip bending and progressive compression sealing between the ball and the seal. This progressive compression sealing is additive in nature to the lip bending concept. The tapered nose portion of the Worcester valve sealing ring 20 functions in substantially the same way to produce substantially the same result as the lip construction defined in claims 7 and 8. The Worcester tapered sealing ring always contacts the ball and increases in thickness substantially uniformly outward in the radial direction. The tapered portion has one face disposed toward the ball and one face disposed away from the ball, and said faces diverge substantially uniformly outward in the radial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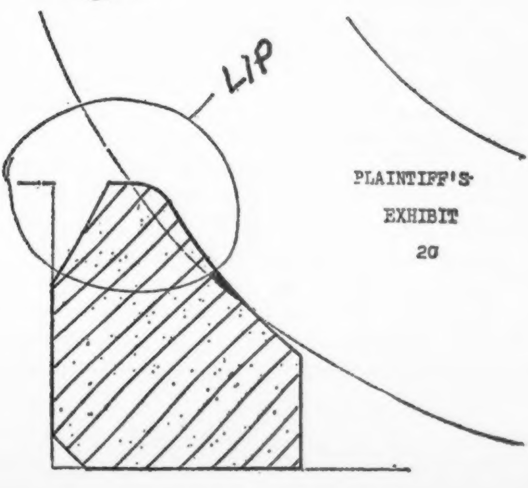
SANCTUARY 2,963,263

Fig. 4.



PLAINTIFF'S
EXHIBIT
20

direction as recited by patent claim 8. The tapered portion of ring 20 has a graduated stiffness and is deflected due to preloading and sealingly contacts the ball at all times. The tapered portion is free to bend in the axial direction. The Worcester ball valve includes all the structural elements recited in patent claims 7 and 8 and said elements function in substantially the same manner and produce substantially the same results as the construction disclosed and claimed.

**24.** Both of the accused ball valve constructions include sealing rings in which grooves are provided in the outer peripheral edge of the sealing ring to permit fluids to escape around the sealing ring on the upstream side of the valve. Defendant has urged that patent claims 7 and 8 are limited by their prosecution to a ball valve having lip bending and sealing on the upstream side. Defendant has also urged that since the accused valves do not provide upstream sealing, they do not infringe patent claims 7 and 8. The prosecution history of the patent in suit shows no intent to limit the claims in suit to either upstream sealing or downstream sealing. Defendant's contentions in this respect are not supported by the evidence.

**25.** Summarizing the above findings of fact, it is concluded that claims 7 and 8 of the Freeman, et al., patent 2,945,666 are valid over the prior disclosures presented by defendant, and that said patent claims have been infringed by the accused Electric Boat Division ball valves and the accused Worcester Valve Co., Inc., ball valves.

**26.** A trial to establish liability in this case was initially held before Commissioner Donald E. Lane (now Judge of the United States Court of Customs and Patent Appeals). After completion of the trial and following the filing of the parties' post-trial briefs and requested findings, plaintiff's ownership of the patent in suit, United States Letters Patent No. 2,945,666 (hereinafter referred to as the '666 patent), was put in issue by E. W. Bliss Co. as intervenor in an infringement action on the '666 patent, in the United States District Court for the District of Massachusetts between Jamesbury Corp. as plaintiff and Worcester Valve Co., Inc., as defendant. In view of the Massachusetts suit, the parties agreed to a stay of proceedings in the present suit, after the commissioner's report had been filed, until ownership of the '666 patent had been settled in the Massachusetts District Court. In his opinion of May 16, 1967, Commissioner Lane found that claims 7 and 8 of the patent in suit were valid and infringed by defendant's unauthorized use of ball valves manufactured by the Electric Boat Division of General Dynamics Corp. and Worcester Valve Co., Inc.

**27.** On June 29, 1971, plaintiff reported to this court that after full trial on the issue of ownership, the United States District Court for the District of Massachusetts entered judgment for Jamesbury Corp. (318 F. Supp. 1) and that this judgment had been affirmed by the United States Court of Appeals for the First Circuit (443 F. 2d 205). At the same time, Jamesbury Corp. moved to remand this suit to the trial division for further proceedings and additional findings of fact on an issue raised by E. W. Bliss Co. and commented upon, without deciding, by the Massachusetts District Court, to wit, whether the named inventors of the patent in suit, Howard G. Freeman and Oscar R. Vaudreuil, were joined in a manner irremediably contrary to applicable law. Thus, at 318 F. Supp. 6, fn. 6, the court stated:

> If relevant, the court would find that Vaudreuil was added to the application as a spurious joint inventor to shield Jamesbury against any claim by Rockwood that its president and principal shareholder had conceived the invention while a Rockwood employee.

On appeal, the First Circuit noted this finding and Jamesbury's strenuous objection that it was erroneous. The First Circuit, after indicating that the finding was clearly dictum and not binding in other litigation, decided that since there was evidence to support it, the dictum could not be said to be clearly erroneous.

In addition, Jamesbury Corp. moved to have the case remanded to the trial division so that additional findings could be made concerning a patent called to plaintiff's attention by Worcester Valve Co., defendant in the Massachusetts action, during settlement discussions between the parties. The patent, Melichar, *et al.*, United States Patent No. 2,409,220 (hereinafter referred to as '220 patent), was, according to plaintiff's remand motion, alleged by Worcester

Valve Co. to constitute a reference highly pertinent to the validity of the patent in suit. Although defendant opposed plaintiff's motion to remand, this court, in an order dated October 1, 1971, remanded the case to the trial division to allow defendant to raise in supplemental pleadings the issues of misjoinder of inventors and the effect of Melichar, *et al.*, on the validity of the claims in suit.

**28.** In supplemental pleadings, defendant raised the defenses of misjoinder of inventors and the effect of Melichar, *et. al.*, on the validity of claims 7 and 8 of the patent in suit. Defendant, as well, also questioned the validity of claims 7 and 8 of the '666 patent in view of Cross British Specification No. 373,660.

In September 1973, a trial, limited to the two above-discussed issues, was held. With regard to the issue of misjoinder of inventors, neither side called any witnesses. Instead, each side read into the record portions of the record from the Massachusetts trial on the ownership question, and, as well, portions of transcripts of depositions taken in connection with that trial. On the issue of patent validity, each side called one expert witness.

**29.** Howard G. Freeman obtained a bachelor of science degree in mechanical engineering from Worcester Polytechnical Institute in June of 1940. Upon graduation, he was hired by the Rockwood Sprinkler Co. (hereinafter referred to as "Rockwood") of Worcester, Mass. He was later named director of research, a position which he continued to hold until January of 1954.

Shortly after entering employment with Rockwood, and specifically on August 28, 1940, Freeman executed an employment agreement wherein he agreed—

> * * * to give to Rockwood the full benefit and enjoyment of any and all inventions or improvements which he may make while in the employ of Rockwood * * * and all inventions which are made or worked out on the time and at the expense of Rockwood. * * *
>
> Said Freeman further agrees that he will without additional consideration disclose promptly to Rockwood all of the above-described inventions or improvements * * *.

During the course of his employment at Rockwood, some 19 United States patents, plus foreign counterparts thereof, issued naming Freeman as inventor or coinventor. Freeman assigned all of his interest in these patents to Rockwood.

30. Freeman, as director of research, was primarily responsible for designing and improving all of Rockwood's products. He also had full authority, without the prior approval of any other company official, to submit ideas which he believed were novel to Rockwood's patent attorneys.

He was included in the company's "key man" program under which company executives received compensation based upon business volume and company profits. At the time of his departure, in 1954, Freeman's compensation was about $25,000 annually.

By the latter part of 1953 the principal products of Rockwood were sprinkler systems, fire fighting equipment, rescue equipment for airports and ball valves. At that time, the ball valves produced by Rockwood were single seat compression-type valves, and constituted between 8 and 10 percent of its total annual sales.

31. The ball valves manufactured by Rockwood while Freeman was employed there utilized a compression seat on only one side of the ball. These seats were sometimes referred to as "jam seats," since a seal is formed by the ball being jammed by a spring or other device against the opposing seat. This design, although commercially successful, had the disadvantage of only being able to control the flow of fluid adequately in one direction. The seats sometimes swelled, making the valves leak and difficult to turn.

From 1945 on, Rockwood's customers occasionally requested ball valves that were capable of controlling the flow of fluid in either direction. Rockwood, however, never manufactured such a valve while Freeman was its director of research.

32. In the fall of 1953, while still director of research, Freeman became dissatisfied with his position at Rockwood and discussed the possibility of going into the ball valve manufacturing business with a personal friend, Saul Reck. After a number of discussions, Reck, who in the past had financed several new business ventures, obtained commit-

ments of about $60,000 from several potential investors. It was contemplated that Reck would manage the financial aspects of the new business, while Freeman would contribute his engineering and design talents. Investors were apparently willing to take a chance on this new business venture on the understanding that there was a good market for double seated ball valves that were made from hard brass bar stock and had soft seats of rubber, nylon, teflon, or similar material.

**33.** On January 13, 1954, Freeman went to William J. Carroll, Rockwood's president, to express his dissatisfaction with his compensation and status at the company. Freeman indicated that he would resign "if something couldn't be done" about it. Freeman was told that he would be given an answer shortly. Failing to hear from Mr. Carroll by January 20, 1954, Freeman sent him a letter of resignation suggesting that his effective resignation date be January 30, 1954. The letter went on, however, to indicate Freeman's willingness to serve an additional reasonable period or to have the resignation take effect sooner at Rockwood's option. On January 25, 1954, Mr. Carroll called Freeman to his office. As a result of the meeting, it was agreed that Freeman would leave that afternoon. Freeman's employment and duties at Rockwood ended on that day.

**34.** Upon leaving Rockwood on January 25, 1954, Freeman called Reck and told him to do what was necessary to obtain the financing for the new company which they had earlier discussed. Freeman and Reck arranged with Boston counsel for the formation of the new company. Jamesbury Corporation's Articles of Incorporation were drawn up and dated January 29, 1954. The contributions by the initial investors were made by checks that had been postdated to February 2, 1954.

**35.** On February 1, 1954, Freeman commenced a series of drawings and sketches of valve parts. Some of these were undated, but none were begun before February 1, 1954. It took Freeman several days to complete the drawings and he did not complete any of the drawings in a single day. While drawing and sketching during the first or second week of February, Freeman commenced drafting a written description of three ideas he was working on. One of these ideas was for a new valve seat. The written statement describing Freeman's new valve seat was completed before February 23, at which time the written description along with five illustrative sketches were taken to his patent attorney in Boston. The written description read in part:

> The new valve seat has both a flexible sealing surface and a non-flexible surface to absorb compression load. By utilizing the design as shown, the lip seal is precompressed before the ball surface strikes the non-flexible surface. The intent of the design is to maintain a definite space between the seat and the ball to allow for swelling.

**36.** On the basis of this material, Freeman's patent counsel prepared a draft of a patent application containing four claims and a drawing consisting of four figures. The claims covered Freeman's V-notch design. The drawings specifically showed a seal configuration which included a "V-notch," substantially as shown in Fig. 5 of application Serial No. '188, that was carved into the seat in order to provide for greater flexibility. The oath accompanying the draft named Freeman as the sole inventor of the subject matter claimed therein.

On April 27, 1954, this draft was forwarded to Freeman for review but there is no indication that Freeman ever

Fig. 5.

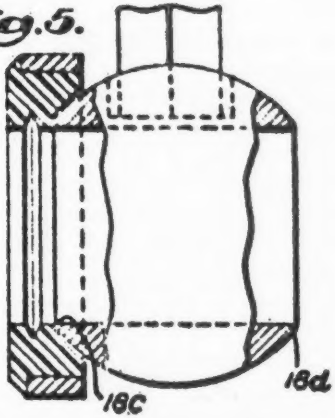


*Figure 5 of the '188 application*

signed it or that it was ever filed in the United States Patent Office. As such, the claims contained in this draft can only be viewed as disclosing the attorney's understanding of Freeman's V-notch valve seat.

37. In the latter part of March 1954, Freeman set up a lathe in space he had rented in Worcester, Mass., and started to make parts for his valve. Shortly thereafter, he also set up apparatus to test the prototype valves he had made. Freeman's initial efforts at producing quality valves were unsuccessful and he continued to experiment with various modifications of his original design. He was particularly concerned that the seats would tear after only a few operations of a valve.

38. Oscar Vaudreuil, now deceased, had a machine shop in Worcester, Mass., which supplied Jamesbury Corp. with parts and services during 1954. Since Jamesbury Corp. had little cash to pay for these goods and services, Vaudreuil accepted stock in the corporation in lieu of money. Vaudreuil observed some of the tests being performed by Freeman. In connection with the seat tearing problem which Freeman's design was experiencing, Vaudreuil suggested that a small part of the metal casing behind the flexible valve seat be chamfered or cut away. This part of the metal casing is represented by 44 in Fig. 9 of the '666 patent. Freeman tried

Fig. 9.

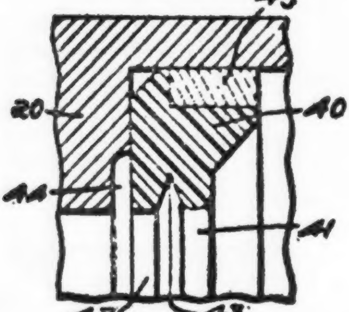


*Figure 9 of the '666 patent*

out this suggestion and it eliminated the tearing of the valve seat that had plagued earlier valves by enabling the lip of the valve seat to move more freely.

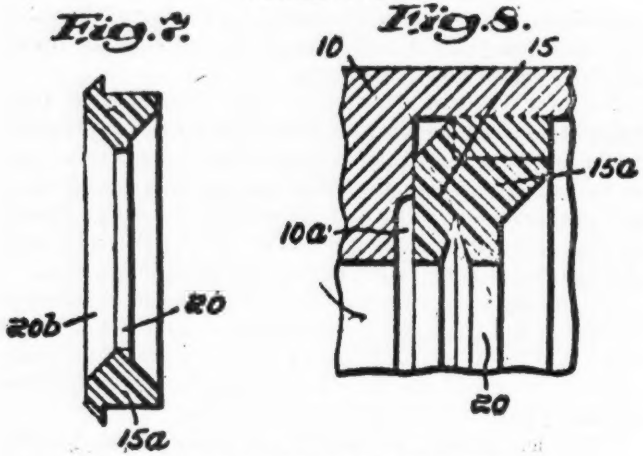
39. As a result of Vaudreuil's suggestion, Freeman concluded that the necessary lip flexibility could also be obtained by cutting away one of the two lips of his V-notch valve seat in lieu of chamfering the metal casing. This modification of the valve seat was further refined into the design shown in Fig. 5, *see* finding 10, and has eliminated the valve seat damage that was prevalent in Freeman's original design.

40. In May 1954, Freeman returned to his patent attorney in Boston and described the changes that he and Vaudreuil had made to the valve. Freeman asked his patent attorney whether Vaudreuil was to be included in the patent application as a coinventor and was told that he was.

The patent attorney revised the previously prepared draft, later filed on June 11, 1954, as Patent Application Serial No. 436,188 (hereinafter referred to as the '188 application), by including therein the embodiments suggested by Vaudreuil and Freeman's modification thereof. More specifically, Fig. 8 of this application showed the changes which Vaudreuil contributed while Fig. 7 showed Freeman's equivalent modification of removing one of the two lips of the "V-notch" valve seat without chamfering the abutting casing.

41. An analysis of the original 10 claims contained in the joint '188 application indicates that claims 1 through 8 are sufficiently generic to read on the Freeman V-notch seat, as well as upon the Freeman-Vaudreuil joint design. Claims 9 and 10 covered the Freeman-Vaudreuil embodiment shown by Figs. 7 and 8. The oath accompanying the '188 application named Freeman and Vaudreuil as joint inventors.

42. As a result of the first amendment to the '188 application while it was pending in the Patent Office, Freeman and Vaudreuil canceled claims 6, 7 and 8 of the original 10 claims. By amendment of August 26, 1957, Freeman and Vaudreuil canceled all of what remained of the original 10 claims and added new claims 11–13. As explained in the remarks accompanying the amendment, "Claim 11 corresponds in substance to Claim 10 * * *." Claim 10, as hereinbefore stated, originally read on the joint Freeman-Vaudreuil invention



*Figures 7 and 8 of the '188 application*

as shown by the Fig. 7 embodiment of the application, *see* findings 40 and 41. Similarly, since new claims 12 and 13 were dependent upon new claim 11, there can be no doubt that the joint inventors limited all of the new claims to their joint invention.

43. On February 14, 1958, the joint inventors filed a continuation-in-part application, Serial No. 715,372 (hereinafter sometimes referred to as the '372 application), with the Patent Office. The drawings of this application illustrated only the joint Freeman-Vaudreuil invention, and did not illustrate the original Freeman V-notch design. Specifically, Figs. 5 and 6 of the '188 application, which illustrated the Freeman V-notch design, were not included in the '372 application. In addition, Figs. 2 and 4 of the '188 application were modified to eliminate the Freeman V-notch seat, *see* Figs. 2 and 4 of the patent in suit. Furthermore, new Figs. 5 and 7, depicting only the joint invention, were added. Fig. 9 of this application is substantially identical to Fig. 8 of the '188 application.

The specification of the '188 application was extensively revised and the entire emphasis shifted. The new specification dealt almost exclusively with the joint invention, and relegated the V-notch design to a four sentence discussion. As a result of the inclusion of language such as "free standing lip," all 10 claims of the new application read only on the joint invention, and not on the sole Freeman invention.

44. The Patent Office, on March 27, 1958, indicated that claims 1 and 3 of the '372 application were—

> * * * unpatentable over the claimed subject matter of applicants' copending application, Serial No. 436,188 which has been indicated as allowable * * *.

In addition, the Patent Office rejected the remaining claims in the application—

> * * * on the claimed subject matter of applicants' copending application, Serial No. 436,188 indicated as allowable in conjunction with Clade [prior art Patent No. 2,792,196].

45. Although by subsequent amendments, *see* the amendment of October 6, 1959, the applicants presented new claim 14, which subsequently issued as claim 7 of the patent in suit, without including the term "free standing lip" or "free standing deflectable lip," the claim cannot be interpreted to read on the original Freeman V-notch seat because to do so would permit the applicants to cover subject matter that was willingly relinquished during the prosecution of the '188 and '372 applications through the Patent Office. On July 19, 1960, the '372 application issued as United States Letters Patent No. 2,945,666.

46. In view of the actions by the joint inventors in prosecuting the '188 and '372 applications, it is concluded that the claims in suit, claims 7 and 8, read on the jointly made Freeman-Vaudreuil invention disclosed in the '666 patent.

### *Prior Art*

47. In 1954 and prior thereto, the ordinary valve designer was either a university graduate in mechanical engineering or a high school graduate who had obtained considerable practical experience under the direction of graduate engineers.

48. Defendant also contends that the claims in suit are invalid since they would have been obvious to one of ordinary skill in the art under 35 U.S.C. 103 in view of the disclosures

of prior United States Patent No. 2,409,220 issued October 15, 1946, on an application filed May 13, 1943, to Joseph F. Melichar and Wilton Margrave, entitled "Sump Selector Valve," and British Patent Specification No. 373,660, accepted June 2, 1932, entitled "Improvements in the Sealing and Lubricating of Valves for Internal Combustion or other Engines and Pumps" by Roland C. Cross.

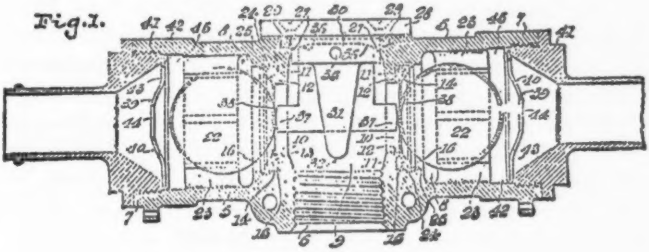
**49.** The Melichar patent discloses a sump selector double check valve designed to prevent air from the higher end of a partially full airplane fuel tank being fed into airplane engines during flight. Figs. 1 and 4 are reproduced herein. As shown in Fig. 1, the valve comprises a casing 5 which is open at both ends. Casing 5 contains an outlet opening 6 that is perpendicular to its longitudinal axis. Inlet openings are provided in the respective ends 7 of the casing. Within each end of the casing is formed a ball valve chamber 8. Central flow chamber 9, having circular openings 10, is disposed in the center of the casing betwen the ball chambers to permit communication therebetween.

Circular openings 10 are provided with seat recesses which are undercut as at 12 to provide an overhanging shoulder. The inner edge corners are rounded, as at 13, in order to prevent damage to the flexible lip of the seat rings. A valve seat ring 14 formed of rubber or other yieldable material is mounted in each recess 11. The rings are removably held in the recesses by a metal mounting or keeper ring 15, which in turn is provided with an inwardly directed keeper flange 16.

Each seat ring 14 includes an obtusely angularly recessed face portion 16, *see* Fig. 4, which results in the provision of a line contact bumper seat 19 and a relatively thin, very flexible lip 20 which projects into the circular openings 10. Each flexible lip is positioned so as to present a line contact seat shoulder 21 toward the respective ball chamber 8. Within each ball chamber 8 are ball guide ribs 23 which serve as guides for the rollably mounted ball valves 22. By reason of the guides, a ball valve rolling against the ring seat will first engage in line contact with the flexible lip 20 as at 21 of Fig. 4. If the tilt of the casing is very slight, the liquid seal will be affected by this contact, but if lip 20

*Figures 1 and 4 of the '220 patent*

Fig.1.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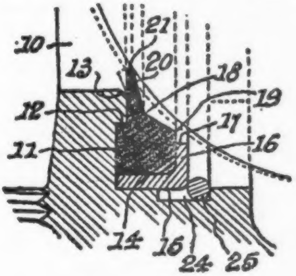
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Fig.4.
(PARTIAL)

is deflected to a sufficient extent, as when there is more than just slight tilting, the ball will next engage the less readily yieldable bumper seat shoulder 19. If this contact is insufficient to form a seal, the ball will next contact rigid support shoulder 17 to form a seal. Bumper seat shoulder 19 and rigid support shoulder 17 limit the movement of the ball into lip 20 and prevent sticking of the ball in the seat ring.

The balls 22 are controlled by pendulum 34 in such a manner that at least one check valve remains open to provide fuel to the airplane engine.

**50.** The claims at issue, *see* findings 5, 10 and 11, call for a sealing ring which has a lip that is free to bend in the axial direction of the ring. In this manner, the lip of the patented ball valve bends with respect to the remainder of the sealing ring. As a result of prestressing, the lip flexes into sealing contact or engagement with the ball at all times, even when the ball is being rotated. The lip projects inward, *see* Figs. 5–7 accompanying finding 10, and the tapered cross-sectional shape in the radial direction results in its having a graduated stiffness. The ball is provided with a truncated fluid passage port, such that reduced ball pressure occurs against the seat when the fluid passage port of the ball is aligned with the opening in the casing. However, when the valve is closed, by a quarter turn of the ball, the non-truncated portions of the ball press into the seat to provide a fluid tight seal.

**51.** The Melichar, *et al.*, valve differs significantly, both in its operation and design, from the Freeman, *et al.*, valve. The Melichar lip is purposely designed to be thin and very flexible and was not intended to be used with a ball having a fluid passage port. Use of a thin, flexible Melichar lip on the upstream side of a ball as shown in the '666 patent could result in the lip being forced into the port when the ball is in the open position. Upon movement of the ball into its closed position, the lip would then be susceptible to being pinched or cut. Thus, while the Melichar, *et al.*, valve was intended to control fluid flow in only one direction, the Freeman, *et al.*, valve can control flow in both directions.

Melichar, *et al.*, was not faced with the problem of insuring a fluid tight seal to a flow which could be coming through the port of a ball in either of two directions. Moreover, since Melichar, *et al.*, was not concerned with a quarter turn ball valve, no attention was given to insuring that the seal would be capable of properly operating with the continuous sealing contact required by the ball valve disclosed and claimed in the patent in suit while the ball is being rotated from an open to a closed position or vie versa. *See* finding 10.

**52.** On the other hand, prestressing is not necessary or required in the totally open or totally closed double check valve of Melichar, *et al.* In fact, while the Freeman, *et al.*, lip is designed to always be in contact with the apertured ball in both its open or closed positions, the solid ball of Melichar, *et al.*, is only in contact with the lip in the closed position. Moreover, the Melichar, *et al.*, lip is not designed or intended to support the ball, in the manner required by the Freeman, *et al.*, lip in the open or closed position of the valve.

**53.** The structure defined by claims 7 and 8 of the patent in suit is novel and unobvious, when considered in its entirety over the double check valve disclosed in Melichar, *et al.*, patent No. 2,409,220.

**54.** The Cross British Patent Specification discloses a continuously rotating plug valve used in internal combustion or other engines, which is designed to alternately connect the cylinder of that engine to an inlet and exhaust manifold. Figs. 3 and 7 are reproduced herein.

The device contains a metallic bearing or liner 1 which is pressed or otherwise fastened into a valve housing 2, and in which a valve 3 rotates to perform its work of opening and closing port 4 in cylinder head 5. This liner 1 has a hole 6 in its wall to register with the port 4. The liner 1 at the periphery of hole 6, and for some distance around it, is shaped with a lip 8 which presses slightly inwards toward the working face of the valve 3. By pressing the liner 1 inwards toward the valve 3 adjacent to the edge of port 4, a slight gap 7 is produced between liner 1 and the valve housing 2. This permits the gas pressure in the cylinder to get underneath the liner for a short distance adjacent to the port and press the edge of the liner against the valve. This also enables the valve to have a good working clearance in the liner, and guarantees, regardless of the position the valve assumes in the clearance of the liner, that lip 8 of the liner will resiliently follow the surface of the valve. A sufficiently gas-tight valve, for all practical purposes, is thus achieved.

Fig. 7 is a detailed view of one of the possible configurations for lip 8.

**55.** As understood, the Cross patent discloses a cylindrical liner which entirely surrounds a cylindrical valve, and is provided with an oval opening along one surface to register with the port of a cylinder. The cylindrical liner is made of cobalt chrome steel so that it can be used as a bearing surface for the valve. At the same time, the liner material is selected to be of sufficient elasticity to allow a resilient lip surrounding the oval opening to be pressed against valve 3. This cylindrical liner is to be distinguished from the seat disclosed by Freeman, *et al.*, which is of a narrow circular configuration. The Freeman, *et al.*, seat is shaped in such a manner that its beveled sides terminate in a lip that is biased inwardly and axially movable. Sealing is initially provided by line contact between the lip and ball. Upon additional fluid pressure, the ball contacts a beveled surface to enhance the sealing ability of the seat. The Cross patent only teaches the use of a lip to seal.

In addition, the Cross and Freeman, *et al.*, seats are designed to achieve substantially different results. Particularly, the Freeman downstream seat achieves maximum contact between the ball and the lip when no fluid is flowing through the ball port, *i.e.*, when the valve is closed. In contrast, the seal of the Cross invention achieves its greatest contact between the lip and the valve when gas is flowing through the cylindrical port into the valve 3.

Moreover, nowhere in Cross is there any disclosure of a sealing ring such as shown in the patent in suit which has a lip position that can be prestressed to cause it to flex into sealing engagement with the inlet and/or outlet ports of a quarter turn ball valve. Cross, furthermore, does not disclose or teach providing his lip with graduated stiffness by increasing its cross-sectional shape in the radial direction of the seat. Indeed, the Cross device does not appear to be subjected to any degree of movement as the ball of the '666 patent may be subjected to in its closed position. Thus, no thought was given by Cross to having the seat be able to support the ball during such periods of increased load. This is done in the '666 patent by the ball flexing the lip to the point where the ball will contact the oblique surface 25 times, *see* finding 10 and Fig. 7.

The above differences in operation, results and structure, coupled with the fact that the Cross patent relates to internal combustion engines, make it highly unlikely that a person having ordinary skill in the art would have considered modifying Cross to obtain the Freeman, *et al.*, seat.

**56.** There are a number of other differences between the Cross device and that of the patent in suit. In the first place, the Cross device does not relate to ball valves. The Cross

*Figures 3 and 7 of the Cross patent*

FIG. 3.

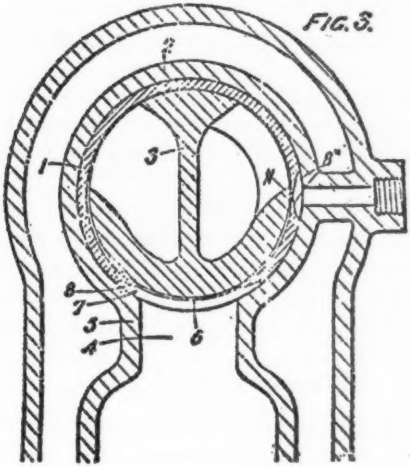
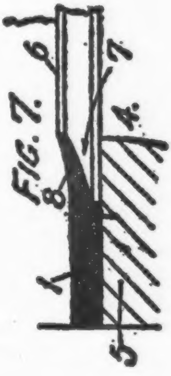


FIG. 7.



*(Rotated 90°)*

device rotates continuously in the same direction to open and close a port. On the other hand, the ball valves of the patented invention open and close by rotating a quarter turn in either direction. Furthermore, the Cross reference discloses a liner and valve arrangement that are in continuous contact to form a seal. In this arrangement, the valve is supported by the bushing in which the cylinder rotates rather than by the lip as in the Freeman device. Moreover, Cross did not intend that his device be capable of handling continuous flow, whereas the Freeman valve is capable of such operation.

**57.** In addition, the valve seats shown by both Melichar, *et al.*, and Cross are not self-compensating with respect to wear and temperature changes as is the Freeman, *et al.*, seat. *See* finding 10.

**58.** In view of these major differences in the construction of the devices, as well as their method of operation, it must be concluded that the devices defined by claims 7 and 8 of the patent in suit are not rendered obvious by the Cross reference either taken alone or in combination with Melichar, *et al.*

### SUMMARY

Claims 7 and 8 are valid over the prior art. Freeman and Vaudreuil are deemed to be joint inventors of claims 7 and 8.

### CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that claims 7 and 8 of United States Letters Patent No. 2,945,666 are valid and have been infringed by the defendant's unauthorized use of ball valves produced by the Electric Boat Division of General Dynamics Corp. and by Worcester Valve Co., Inc., that plaintiff is entitled to recover reasonable and entire compensation therefor, and judgment is entered to that effect. The amount of recovery will be determined pursuant to Rule 131(c)(2).

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525 F. 2d 1380

## NIAGARA MOHAWK POWER CORPORATION v. THE UNITED STATES

[No. 248-73. Decided October 22, 1975]*

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

**Taxes; income tax; deductions; depreciation; obsolescence; exchange of property; basis of property; cost v. fair market value;**

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*On the parties' motions for rehearing, see the order dated January 9, 1976, reported in part *post* at 594.

water rights.—Plaintiff, a publicly held New York corporation engaged in the sale of electric power and natural gas in New York State, seeks to recover an alleged overpayment of federal income tax and interest for taxable years 1957–1962. Defendant has moved for partial summary judgment respecting the claim asserting entitlement to deductions, in those years, for obsolescence of certain water rights owned by plaintiff's predecessors as of March 1, 1913. In 1950 plaintiff acquired the water rights from its predecessor in a tax-free merger, said predecessor having acquired in 1918 the water rights in a tax-free consolidation with other companies. Federal regulation of plaintiff's water rights began with enactment in 1920 of Pub. L. 280, but this law did not abolish plaintiff's existing state rights to use the navigable waters for power purposes. Pursuant to said law plaintiff's predecessor in 1921 secured from the Federal Power Commission a 50-year license authorizing diversion of water from the Niagara River. Under New York State law, plaintiff's right to use the water was a recognized property right which, prior to enactment in 1957 of Pub. L. 85–159, was of indefinite duration. Pub. L. 85–159 authorized the FPC to license the Power Authority of the State of New York (PASNY) to undertake the Niagara redevelopment as power projects by private parties. In 1961, pursuant to Pub. L. 85–159 and in return for surrender of its water rights, plaintiff contracted with PASNY for the sale to plaintiff for designated periods the amount of power previously generated by plaintiff for resale to industries previously purchasing power from plaintiff, as well as sale of an additional amount of power. On the theory that its water rights had been rendered obsolete by enactment of Pub. L. 85–159, plaintiff deducted from income the alleged value of the water rights over the period 1957–1962. Upon disallowance, plaintiff paid the deficiencies and interest, filed claims for refund and, absent refund within the statutory period, filed suit in this court. For the first time, defendant asserts that plaintiff's waiver of its water rights in return for the contract with PASNY was a taxable exchange of property subject to Secs. 1001 and 1002 of the 1954 Code, and that the cost of the water rights was zero. Plaintiff counters that if the transaction is properly viewed as an exchange, it suffered a substantial loss on the exchange, that the basis for loss was the fair market value as of March 1, 1913, and that at least a portion of the water rights had a cost for tax purposes arising out of a merger consummated in June 1910. It is *held* (1) that plaintiff's claim as to obsolescence is without merit. The water rights did not become less valuable and were not forced into disuse; they are currently in use and only plaintiff's use was ended in 1961; (2) that plaintiff's water rights were exchanged for the contract right to receive power from PASNY; (3) that the 1954 Code governs the 1961 exchange and requires that plaintiff's basis be measured by cost, not fair market value, as of March 1, 1913; and (4) that the water rights did have a cost for tax purposes arising out of the merger consummated in June 1910, plaintiff being entitled to a literal application of Sec. 1012 of the 1954 Code. Plaintiff must prove the amount of its basis in the water rights as well as the value of the contract with PASNY, and the case is remanded to the Trial Division for further proceedings consistent with the opinion. Defendant's motion for partial summary judgment is denied.

**Taxes; income tax; deductions; depreciation; useful life.**

[1] The useful life of an asset is the period over which the asset may reasonably be expected to be useful in the taxpayer's trade or business. This period is to be determined by reference to taxpayer's experience, unless that experience is inadequate, in which case the general experience of the industry may be used. The useful life of an asset is not to be measured by taxpayer's period of use before transferring it to another.

Internal Revenue 🔑 715

**Taxes; income tax; deductions; depreciation; tangible property; water rights.**

[2] Like land, which is by regulation nondepreciable, water rights do not wear out. Under New York State law, the right to use water for generation of power constitutes a form of real estate known as a corporeal hereditament.

Internal Revenue 🔑 719

**Taxes; civil action for refund of taxes; variance between administrative claim and grounds of civil action; waiver.**

[3] A ground for refund of a tax neither specifically raised by, nor comprised within the general language of, a timely formal or informal application for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated. However, where the Government interjected a defense in its motion for summary judgment not previously relied on in denying the administrative claim, the Government has waived its right to object to taxpayer's response which advanced a ground for recovery different from that set out in the claim for refund but which was based on the Government's new position, and taxpayer is entitled to have the new issue judicially decided.

Internal Revenue 🔑 2028

**Taxes; income tax; gain or loss on disposition of property; basis of property.**

[4] Where plaintiff in 1961 exchanged its water rights in return for a contract with the Power Authority of the State of New York providing for sale to plaintiff of the amount of power previously generated by plaintiff, the basis of the water rights is governed by the 1954 Code. Plaintiff, having acquired said water rights from its predecessor in a tax-free merger in 1950 and the latter having acquired the water rights in 1918 in a tax-free consolidation with other companies, in view of Sec. 1012 of the 1954 Code, Sec. 1052(b) is applicable directing reference to certain subparagraphs of Sec.

**113(a)(7) of the 1939 Code in determining plaintiff's basis for income tax purposes in the water rights from the 1961 exchange. Thus, since plaintiff's basis in the water rights under Sec. 113(a)(7)(B) is the same as it would have been for its predecessor if the latter had owned the water rights in 1961, and since the basis for plaintiff under Sec. 113(a)(7)(A) is the same as it would have been if the pre-1918 entities had owned the water rights in 1961, by virtue of Sec. 1012 and either Sec. 1052(c) or Sec. 362(b) of the 1954 Code, that basis is cost. Sec. 113(a)(7)(12) not having been referred to in Sec. 1052(c) is not applicable here.**

**Internal Revenue ⚷ 717**

**Taxes; income tax; gain or loss on disposition of property; basis of property; cost.**

**[5] Where plaintiff's predecessor H corporation in June 1910 merged with M corporation, H exchanging its $14.5 million in securities for $500,000 of stock of M whose assets, including its water rights, thereby became the property of H, the cost of the water rights to H was some part of the value of the securities paid to M and therefore the basis of the water rights involved in plaintiff's 1961 exchange thereof for a contract with the Power Authority of the State of New York to supply plaintiff with the amount of power it previously generated.**

**Internal Revenue ⚷ 717**

*S. Hazard Gillespie*, attorney of record, for plaintiff. *Wallace S. Jones*, *John A. Corry*, *Edmund S. Cohen*, of counsel.

*Theodore D. Peyser*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant.

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Before Cowen, *Chief Judge*, Laramore, *Senior Judge*, and Bennett, *Judge*.

Bennett, *Judge*, delivered the opinion of the court:

Plaintiff, Niagara Mohawk Power Corporation (Niagara Mohawk), seeks to recover an alleged overpayment of federal income tax and interest for its taxable years 1957–1962 in the amount of $27,679,359. Defendant has moved for summary judgment as to that part of plaintiff's claim which asserts an entitlement to deductions, in those years, for obsolescence of certain water rights owned by plaintiff's predecessors as of March 1, 1913. In opposition to defendant's motion, plaintiff contends that there are issues of fact which preclude summary judgment on the legal issues. We consider the case upon the briefs and oral argument of counsel.

## I

Niagara Mohawk is a publicly held New York corporation engaged in the sale of electric power and natural gas in upper New York State. During the period 1881 through 1961, Niagara Mohawk and its predecessors operated hydroelectric plants at Niagara Falls which generated electrical power through diversion of water from Niagara River.

Plaintiff's use of the water during the period relevant herein was subject to both state and federal law. Under New York State law plaintiff's right to use the water (coupled with an obligation to return the water to the river) was a recognized property right—more specifically, a form of real estate known as a corporeal hereditament. *See Federal Power Comm'n* v. *Niagara Mohawk Power Corp.*, 347 U.S. 239, 246–47 (1954). The parties agree that prior to enactment in 1957 of Pub. L. 85–159, 71 Stat. 401 (to be discussed below), plaintiff's water rights were of indefinite duration.

Federal regulation of plaintiff's water rights began with passage of the Federal Water Power Act of 1920, ch. 285, 41 Stat. 1063. The plan of the Act was one of "reasonable regulation of the use of navigable waters, coupled with encouragement of their development as power projects by private parties." *Federal Power Comm'n* v. *Niagara Mohawk Power Corp.*, *supra* at 251. The Supreme Court held in the above-cited case that the Act did not abolish private proprietary rights such as plaintiff's, existing under state law, to use the waters of navigable streams for power purposes.[1]

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[1] "The Act treats usufructuary water rights like other property rights. While leaving the way open for the exercise of the federal servitude and of federal rights of purchase or condemnation, there is no purpose expressed to seize, abolish or eliminate water rights without compensation merely by force of the Act itself. [Footnote omitted.]

"The references in the Act to preexisting water rights carry a natural implication that those rights are to survive, at least until taken over by purchase or otherwise. [Footnote omitted.] Riparian water rights, like other real property rights, are determined by state law. Title to them is acquired in conformity with that law. The Federal Water Power Act merely imposes upon their owners the additional obligation of using them in compliance with that Act." [*Federal Power Comm'n* v. *Niagara Mohawk Power Corp.*, 347 U.S. 239, 251–52 (1954).]

Pursuant to the Act plaintiff's predecessor secured from the Federal Power Commission in 1921 a federal license, for a term of 50 years, authorizing diversion of water from the Niagara River. A treaty[2] between the United States and Great Britain, relating to boundary waters between the United States and Canada, limited the diversion to 20,000 cubic feet per second (c.f.s.).

In 1950 the United States and Canada entered into a new treaty which substantially increased the amount of water each country was permitted to divert. For the United States the permitted diversion was increased from 20,000 c.f.s. to 65,000 c.f.s. In approving the treaty, the Senate reserved the right to designate the entity which would redevelop the United States share of water. Such designation was, however, delayed for several years while Congress debated whether the redevelopment should be undertaken by a private concern or by the Power Authority of the State of New York (PASNY).

Plaintiff had originally supported a plan under which it would have participated in the redevelopment, but plaintiff altered its thinking after a series of rockslides on June 7, 1956, crushed the larger of plaintiff's two hydroelectric plants and swept it into the Niagara River. Plaintiff's generating capacity had suddenly been reduced by 80 percent. Following the rockslide, plaintiff believed that public redevelopment was inevitable and that plaintiff's continued opposition could only delay that redevelopment at the cost of considerable damage to plaintiff's goodwill. It was feared that delay would drive industry from the Niagara Falls area and deter potential customers from locating in other geographic regions to which Niagara Mohawk provided power. Yet, plaintiff needed a permanent source of power to compensate for the loss brought about by the rockslide. Consequently, on April 10, 1957, in a prepared statement, plaintiff's president told a Senate subcommittee that plaintiff would surrender its license and water rights in return for specific legislative assurance that plaintiff would be able to purchase from

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[2] 36 Stat. 2448, proclaimed May 13, 1910.

PASNY power equivalent to the power generated by plaintiff prior to the rockslides:

> We have indicated to the power authority that, upon fair terms, we would surrender not only our license and our rights thereunder, but all our riparian and other water rights and claims for compensation or damages, except just compensation for tangible property actually taken. This would mean, of course, that we would cease to generate power at our Adams plant and in our restored units in the Schoellkopf plant.
>
> In return for the surrender of these rights, under the provisions of S. 1037, from the 750,000 kilowatts to be generated by the power authority with the water we now utilize, Niagara Mohawk would purchase 445,000 kilowatts, the equivalent of the amount produced by us in the licensed project prior to the Schoellkopf disaster. We would purchase this amount of power for the period ending on the final maturity date of power authority bonds issued to finance the project. We would pay for the power on the same terms as will be available to other purchasers of power from the authority. Under the bill, the 445,000 kilowatts of power would be sold to Niagara Mohawk for the same general purposes for which power from our licensed project was utilized and, as the bill recites, "in order to restore as nearly as possible low power costs." Further, under the bill, the power authority's contract with us would require the approval of the governor of the State of New York. [*Hearings Before a Subcomm. of the Senate Comm. on Public Works on S. 512 and S. 1037*, 85th Cong., 1st Sess., pp. 181–82 (1957).]

Congress thereafter, on August 21, 1957, enacted Pub. L. 85–159, 71 Stat. 401, authorizing the Federal Power Commission to license PASNY to undertake the Niagara redevelopment project on certain conditions. One condition was that PASNY contract to sell plaintiff, for a prescribed period, the amount of power (445,000 kw.) previously generated by plaintiff, for resale to the industries which purchased power from plaintiff's Niagara project prior to June 7, 1956. In order to obtain the contract, however, the Act required plaintiff to surrender its license and "waive all claims to compensation or damages based upon loss of or damage to riparian rights, diversionary rights, or other rights relating to the diversion or use of water, * * *." 71 Stat. at 402.

Pursuant to the Act, PASNY and Niagara Mohawk entered into a contract dated February 10, 1961. The contract provided for the sale of the 445,000 kw. of replacement power referred to in the Act, for the period ending January 1, 1990, or at the election of taxpayer, for the period ending January 1, 2006. The contract also provided for the sale of an additional 745,000 kw. of power through January 1, 1990. All provisions of the Act were incorporated into the contract by reference. Niagara Mohawk surrendered its license on October 1, 1961.

On the theory that its water rights had been rendered obsolete by the enactment of Pub. L. 85–159, plaintiff deducted from income the alleged value of these water rights over the period 1957–1962. These deductions were disallowed. Plaintiff paid the deficiencies with interest on October 31, 1972, and on February 5, 1973, plaintiff filed claims for refund. When no refund was forthcoming within the 6 months allowed by law, plaintiff on August 8, 1973, filed its petition in this court.

In its motion for partial summary judgment defendant asserts, for the first time in this litigation, that plaintiff's waiver of its water rights in return for the contract with PASNY was a taxable exchange of property subject to sections 1001 and 1002 of the Internal Revenue Code of 1954. Defendant then argues that plaintiff incurred no loss on the exchange.[3] In reply, plaintiff states that if the transaction is properly viewed as an exchange, then plaintiff did suffer a substantial loss on that exchange.

## II

If there are disputed material factual issues which must first be resolved on the merits, then we cannot grant defendant's motion for summary judgment. Rule 101(d). Plaintiff alleges that there are four such issues.

First, says plaintiff, there is the issue of Niagara Mohawk's motive for withdrawing opposition to legislation authorizing public redevelopment at the Niagara River. While we doubt the relevance of this "issue," it has in any case been mooted because defendant has accepted, for purposes of its motion, the motive claimed by plaintiff, *i.e.*:

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[3] The possibility that plaintiff realized a gain on the alleged exchange need not be considered herein because the Internal Revenue Service did not on audit include any amount in income for 1961 on account of the exchange.

> * * * following the rockslide, plaintiff believed that the enactment of such legislation was inevitable and that Niagara Mohawk's continued opposition could only delay its passage at the cost of considerable damage to plaintiff's goodwill.

The second asserted factual issue is whether Niagara Mohawk exchanged its water rights for the contract with PASNY. There is, however, no genuine issue here. The contract, which incorporates Pub. L. 85–159, shows that an exchange was made. No testimony can alter the transaction clearly set out in those documents.

Thirdly, plaintiff argues that the value of its contract with PASNY is in dispute. This is no doubt so, as defendant would likely assign it a higher value than would plaintiff, if the need for valuation arose. But resolution of this factual issue, if it becomes necessary at all, is required only *after* the legal issues raised herein by defendant's motion are decided. It is thus no barrier to consideration of defendant's motion.

Finally, plaintiff argues that the cost of plaintiff's water rights is disputed. As with the previous issue—that involving the value of plaintiff's contract with PASNY—this issue comes into play, if at all, only after the legal issues presented herein have been decided.

There are thus no issues of fact to impede our consideration of defendant's motion, to which we now turn.

## III

Plaintiff's primary claim is that it is entitled to take deductions for depreciation of its water rights over the period 1957–1962. Plaintiff relies on section 167(a) of the Internal Revenue Code of 1954, which states:

> (a) GENERAL RULE.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—
>
> (1) of property used in the trade or business, or

(2) of property held for the production of income.

It is plaintiff's theory that the enactment of Pub. L. 85–159 in 1957 rendered Niagara Mohawk's water rights obsolete by establishing a date after which Niagara Mohawk would no longer be able to utilize them. Plaintiff suggests that, while prior to Pub. L. 85–159 the water rights had an indeterminate life and therefore could not be depreciated, the enactment of Pub. L. 85–159 limited and thus defined their useful life. We find this claim to be without merit.

The useful life of an asset is the period over which the asset may reasonably be expected to be useful in the taxpayer's trade or business. Treas. Reg. § 1.167(a)–1(b) (1962); *Massey Motors, Inc.* v. *United States*, 364 U.S. 92 (1960); *Pennsylvania Power & Light Co.* v. *United States*, 188 Ct. Cl. 76, 411 F. 2d 1300 (1969). This period is to be determined by reference to the taxpayer's experience, unless that experience is inadequate, in which case the general experience of the industry may be used. Treas. Reg. § 1.167(a)–1(b) (1962). By either of these criteria, the useful life of plaintiff's water rights was indeterminate. Like land, which is by regulation[4] nondepreciable, water rights do not wear out. It will be recalled that under New York State law, plaintiff's water rights were classified as a form of real estate.

More to the point, however, plaintiff has not demonstrated that Pub. L. 85–159 rendered its water rights obsolete. Indeed, it cannot. The same water rights enjoyed by plaintiff until 1962 are now owned and put to use by PASNY. The water rights did not become obsolete; they were simply transferred or given up to another user. The water rights continue to have an indeterminate useful life in the hands of PASNY.

Useful life of an asset is the period of usefulness in taxpayer's business, not a lesser period during which taxpayer chooses to use the asset before transferring it to another user. A claim similar to plaintiff's was made in *Hilaire P. Coussement*, 25 T.C.M. 930 (1966), *aff'd*, 391 F. 2d 227 (6th Cir. 1968). There the taxpayer sought to depreciate a building held for rental purposes based on a useful life of 20 years, because 20 years was his life expectancy, and he reasoned that the building would therefore be useful to him for only that period of time. The Tax Court dismissed his claim, stating:

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[4] Treas. Reg. § 1.167(a)–2 (1962).

> There is no merit in such a bizarre suggestion. The useful life of rental property for depreciation purposes is not based on the life expectancy of the owner. We hold for respondent.

Similarly, the useful life of the water rights is not to be measured by plaintiff's period of use.

Obsolescence cases cited by plaintiff do not support its position. *V. Loewers Gambrinus Brewery Co.* v. *Anderson*, 282 U.S. 638 (1931), and *Burnet* v. *National Indus. Alcohol Co.*, 282 U.S. 646 (1931), involved property used in the manufacture and sale of beer, ales, and porter, which property was rendered obsolete by prohibition. The property was not commercially adaptable for any other use, or, in the *Burnet* case, was reduced to a fraction of its earlier value. In contrast, the water rights which plaintiff seeks to depreciate did not become less valuable and were not forced into disuse. They are used to this day. Only plaintiff's use ended in 1961. *Gulf Coast Irrigation Co.*, 24 B.T.A. 958 (1931), is inapposite for the same reasons.

## IV

Insofar as the water rights under discussion are concerned, plaintiff's application for refund to the Internal Revenue Service was based solely on the obsolescence argument which has been found meritless. Normally, this would conclude our discussion, for, as we stated in *Union Pac. R.R.* v. *United States*, 182 Ct. Cl. 103, 108, 389 F. 2d 437, 442 (1968),

> [i]t is an undisputed general rule that a ground for refund neither specifically raised by, nor comprised within the general language of, a timely formal or informal application for refund to the Internal Revenue Service cannot be considered by a court in which a suit for refund is subsequently initiated. * * *.

*See also J. O. Johnson, Inc.* v. *United States*, 201 Ct. Cl. 315, 476 F. 2d 1337, *cert. denied*, 414 U.S. 857 (1973). Nevertheless, the general rule is subject to an important exception—one which we think is applicable here—namely, that the Government can waive the requirement. *Tucker* v. *Alexander*, 275 U.S. 228 (1927); *Bear Valley Mutual Water Co.* v. *Riddell*, 493 F. 2d 948 (9th Cir. 1974); *Brown* v. *United States*, 427 F. 2d 57 (9th Cir. 1970); *Mennen Co.* v. *Kelly*, 137 F. 2d 866 (3d Cir. 1943); *Red River Lumber Co.* v. *United States*, 134 Ct. Cl. 444, 139 F. Supp. 148 (1956).

In the instant case, defendant has introduced in its motion for summary judgment a defense to plaintiff's obsolescence claim which was not previously raised by the Government in denying plaintiff's claim at the administrative level, and which was not anticipated by any of plaintiff's submissions prior to defendant's motion. The defense thus raised for the first time is that plaintiff's waiver of its water rights in return for the contract with PASNY was a taxable exchange of property subject to sections 1001 and 1002 of the Internal Revenue Code of 1954. Defendant not only carefully sets out in its motion the elements of the exchange, but, in apparent anticipation of plaintiff's reply, argues in detail that plaintiff did not suffer a loss on the exchange for which a deduction could be taken. It comes as no surprise that plaintiff, in its reply, argues that if the transaction is to be viewed as an exchange, then plaintiff suffered a loss on the exchange.

Defendant did not need to introduce this new defense in order to rebut plaintiff's obsolescence argument. Apparently it did so because it felt its overall defense was thereby strengthened, even though it might have to litigate the loss-on-the-exchange issue as a result. This is a waiver by defendant, and plaintiff is entitled to have this new issue decided. Our decision in this matter is consistent with that of *Brown* v. *United States*, *supra*, whose holding was recently described by that court to be as follows:

> * * * the government, by interjecting a defense at trial different from that relied on in disallowing the claim, waived its right to object to the taxpayer's response, which advanced a ground for recovery different from that set out in the claim for refund, but which was based on the government's new position. * * *. [*Bear Valley Mutual Water Co.* v. *Riddell*, *supra*, 493 F. 2d at 952.]

We agree with defendant that plaintiff's water rights were exchanged for the contract rights to receive power from

PASNY. We must therefore determine whether plaintiff suffered a loss on the exchange.

## V

Defendant argues that as a matter of law plaintiff incurred no loss on the exchange because Niagara Mohawk's basis in the water rights for determining loss was zero. Plaintiff, on the other hand argues that it had a substantial basis for loss in the water rights. The dispute breaks down into two issues. The first is whether the basis is to be measured by the cost of the water rights to plaintiff and its predecessors, which defendant contends was zero, or whether, as plaintiff contends, the basis for loss was the fair market value (f.m.v.) as of March 1, 1913. The second issue, reached only if defendant carries the day on the first, is whether the cost of the water rights was zero or an amount equal to f.m.v. of the water rights on June 3, 1910. We proceed to the first issue.

### (1)

The parties agree that the basis for determining loss of property exchanged in a particular tax year is governed by the revenue law applicable to that year. INT. REV. CODE of 1954, § 1011. Since the exchange in question took place in 1961, the applicable provisions are those of the 1954 Code. We conclude that the 1954 Code requires that plaintiff's basis be measured by cost, not f.m.v. as of March 1, 1913.

Section 1012[5] of the 1954 Code states that the "basis of property shall be the cost of such property, except as otherwise provided" elsewhere in the Code. The Code does contain another provision which is applicable, namely, section 1052(c). That section provides:

> (c) INTERNAL REVENUE CODE OF 1939.—If the property was acquired, after February 28, 1913, in a transaction to which the Internal Revenue Code of 1939

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[5] "§ 1012 BASIS OF PROPERTY—COST

"The basis of property shall be the cost of such property, except as otherwise provided in this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses). The cost of real property shall not include any amount in respect of real property taxes which are treated under section 164(d) as imposed on the taxpayer."

> applied, and the basis thereof, for purposes of the Internal Revenue Code of 1939, was prescribed by section 113(a)(6), (7), (8), (13), (15), (18), (19), or (23) of such code, then for purposes of this subtitle the basis shall be the same as the basis therein prescribed in the Internal Revenue Code of 1939.

Section 1052(c) is applicable first because Niagara Mohawk acquired the water rights from predecessor Niagara Falls Power Company in a tax-free merger in 1950, and thus the transaction was governed by the Internal Revenue Code of 1939. It is applicable also because the basis of the property (water rights) acquired in the merger was prescribed by section 113(a)(7) of the 1939 Code, which provides:

> (7) TRANSFERS TO CORPORATION. *If the property was acquired—*
>
> (A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 50 per centum or more remained in the same persons or any of them, or
>
> (B) *in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization,*
>
> *then the basis shall be the same as it would be in the hands of the transferor*, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer. [Emphasis supplied.]

Section 113(a)(7)(B) thus directs that the basis for plaintiff is the same as it would have been for predecessor Niagara Falls Power Company, if Niagara Falls had owned the water rights in 1961. Under the 1954 Code that basis would be cost (see section 1012) unless another provision applied. Again, however, section 1052(c) does apply. It applies because Niagara Falls Power Company, plaintiff's predecessor, in turn acquired the water rights in 1918 in a tax-free consolidation with other companies. The basis of the water rights acquired was prescribed, during the 1939 Code years, by section 113(a)(7) of the 1939 Code, quoted above. Section 113(a)(7)(A) thus directs that the basis for plaintiff is the same as it would have been if the pre-1918 entities had owned the water rights in 1961. Under section 1012 of the 1954 Code, that basis is cost.

*To arrive at a result other than cost, plaintiff relies on section 113(a)(12) of the 1939 Code in conjunction with various provisions of prior Revenue Acts. Taken together, these statutes in plaintiff's view lead to the conclusion that the basis of each of its predecessors in the water rights—and therefore its basis under applicable carryover rules—was f.m.v. as of March 1, 1913.

Section 113(a)(12) of the 1939 Code does not apply in the decision which we enter today. As stated above it is the 1954 Code which is controlling. That Code prescribes cost as the basis unless another section of the 1954 Code otherwise provides. Section 1052(c) does *not* refer to section 113 (a)(12) of the 1939 Code. Thus, if plaintiff were correct in arguing that section 113(a)(12) of the 1939 Code, rather than section 113(a)(7), prescribed the basis of the water rights under that Code, then section 1052(c) of the 1954 Code simply would be inapplicable. In such a case, sections 1012 and 362(b) (the latter section providing for a carryover basis of property acquired in a tax-free reorganization) of the 1954 Code control and lead to the same result—namely, that plaintiff's basis is the cost of the water rights to its pre-1918 predecessors.

(2)

The cost of the water rights, defendant says, was zero, and in the conventional use of the term "cost" defendant is correct, for there is no allegation that the water rights were originally purchased for a sum of money or for property. However, plaintiff argues that at least a portion of the water rights did have a cost for tax purposes, arising out of a merger which was consummated on June 3, 1910. That cost is alleged to be the f.m.v. of the water rights on the date of the merger, estimated by plaintiff to be $15 million.

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*At this point, the slip opinion has been amended to reflect the substitute language set forth in the order of the court dated January 9, 1970.

The mechanics of the merger are as follows: Prior to 1910 the Niagara Falls Hydraulic Power and Manufacturing Co. (Manufacturing) exercised certain water rights at Niagara Falls subject to regulation by the New York Public Service Commission. In 1909 the Cliff Electric Distributing Co. (Cliff) was set up so that Manufacturing could transfer certain property, not including the water rights, to it. In return for the property assets, Manufacturing received all of Cliff's stock plus bonds. Subsequently, on March 25, 1910, the Hydraulic Company of Niagara Falls (Hydraulic) was incorporated with the same proprietary interests as Manufacturing. Hydraulic issued $2.5 million in bonds and $12 million par value of stock. On June 3, 1910, Manufacturing was merged into Hydraulic, the latter exchanging its $14.5 million in securities for the $500,000 of stock of Manufacturing. Manufacturing's assets, including its water rights, thereby became the property of Hydraulic. It appears that the book cost of the assets acquired from Manufacturing was increased by $11,800,482.24 as a result of this merger, at least in large part because of value assigned to the water rights.[6]

Plaintiff relies on the literal language of the Code and on very similar cases of the Tax Court which uphold its view. Defendant argues that to permit the water rights to acquire a cost through the merger is to elevate form over substance contrary to reasoned administration of the tax laws. In this admittedly close question, we conclude that plaintiff should prevail.

We have seen that by virtue of section 1012, and either section 1052(c) or section 362(b) of the 1954 Code, plaintiff's basis in the water rights was the cost of those rights to Hydraulic. Hydraulic acquired the rights in the 1910 merger as one of the properties formerly held by Manufacturing. Treas. Reg. § 1.1012(1)(a) (1962) states that the cost of property is "the amount paid for such property in cash or other property." Thus, the cost of the water rights to Hydraulic was some part of the value of the $14.5 million in securities paid to Manufacturing.[7] It is quite possible, as plaintiff states, that the value of the stock paid for the water rights will have to be in turn measured by the f.m.v. of the water rights. *Cf.* Rev. Rul. 55-443, 1955-2 CUM. BULL. 562. We need not decide here what the cost was, however; we only decide that the water rights had a cost.

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[6] *See Niagara Falls Power Co.*, 3 F.P.C. 206, 222 (1942).

[7] We see no significance in the fact that Hydraulic exchanged securities for Manufacturing's stock rather than its assets. The result was the same, *i.e.*, Hydraulic acquired all of the assets. *Cf. Kimbell-Diamond Milling Co.*, 14 T.C. 74 (1950), *aff'd*, 187 F. 2d 718 (5th Cir. 1951), *cert. denied*, 342 U.S. 827 (1951).

The Tax Court has come to the same result in very similar cases. In *Maltine Co.*, 5 T.C. 1265 (1945), *acquiesced in*, 1946-1 CUM. BULL. 3, the issue was whether the taxpayer was entitled to an equity invested capital credit for intangible assets acquired from another corporation in 1898. Under the applicable Code provision, the taxpayer was entitled to the credit in an amount equal to its basis for determining loss upon a sale or exchange. The intangible assets—patents, trademarks, and goodwill—had been written up in book value in the 1898 transaction which, like our own, had involved two corporations owned by the same stockholders. The Tax Court noted that if the transaction had occurred in later years, it would have qualified as a tax-free reorganization in which case taxpayer would have been required to use its transferor's basis. Nevertheless, the court approved the use of the stepped-up basis on the grounds that the statute required it and that it was up to Congress to fashion an exception for this case, if it so desired. The court was not swayed by the Government's contention, similar to that being made in the instant case, that the transaction was but the "write up" of goodwill and the declaration of a stock dividend.

The case of *I. Lewis Corp.*, 22 T.C.M. 35 (1963), dealt with whether taxpayer corporation had suffered a loss in 1954 because of abandonment of certain trademarks, patents, and brand names acquired in 1910 from a sole proprietorship. In 1910 the corporation had purchased all assets, and assumed all liabilities, of the sole proprietorship; in return the sole proprietorship received stock of the corporation. On its books the corporation valued the trademarks, etc., at $2.6 million though they had not been listed as assets on the proprietorship books. The Tax Court approved the stepped-up basis, stating at 43-44:

> Respondent argues that the amount of loss is to be limited by Israel Lewis' basis in the abandoned brands.

> His argument is that no transferee ever receives a higher basis for assets received in a transfer unless the transferor recognizes gain on the transfer. Although the 1910 transfer was by its very date nontaxable, respondent argues that it would have been nontaxable if occurring between March 1, 1913, and December 31, 1920. [Footnote omitted.] * * *.
>
> Since Israel Lewis, as an individual, could not under any circumstances be subject to any personal income tax in 1910, we cannot accept respondent's argument, intriguing though it may be. Also, we find no provision in the Internal Revenue Code overriding section 1012, and thus petitioner's basis in the abandoned brands is its cost, measured by the fair market value of its stock issued therefor, or in the absence of any market value, the value of the brands transferred.

We are not unmoved by defendant's assertion that the "change in form," which the 1910 merger was for many purposes, should not affect the basis of the water rights. Ignoring the separate corporate entities, it might be said that by purchasing the water rights from itself, plaintiff created a cost for those water rights. While plaintiff is thus receiving the benefit of a fortuitous event, it is nevertheless clear that there was no tax avoidance motive, because there was no tax. The merger was thus done for business reasons—no doubt primarily to alter the capital structure of the business.

Congress could have provided an exception to section 1012 to meet the circumstances presented here, but has not done so. We conclude that plaintiff is entitled to a literal application of the Code.

This decision does not, of course, assure a recovery by plaintiff in this court for loss on the exchange of the water rights. Plaintiff must prove the amount of its basis in the water rights as well as the value of the contract with PASNY received in exchange. If the contract with PASNY had a value equal to or greater than plaintiff's basis in the water rights, plaintiff has not suffered a loss.

Defendant's motion for partial summary judgment is denied. The case is remanded to the Trial Division for further proceedings consistent with this opinion.

Syllabus

ON REHEARING

January 9, 1976

In addition to amending the language appearing in the slip opinion, page 12, line 3, through page 13, line 2 (the revised language is reflected in the foregoing report of the opinion), the order of the court dated January 9, 1976 reads in part as follows:

"This case is presently before us on motions by both parties for rehearing. The United States challenges part IV of the opinion filed October 22, 1975, wherein we held defendant to have waived its defense relating to taxpayer's failure to raise in its refund claim one of the theories propounded to us in this court. Plaintiff attacks part V(1) of the opinion, holding its basis in certain water rights to be that which it would be in the hands of plaintiff's pre-1918 predecessors—namely, cost.

"We have examined these motions with care, and conclude that they should not be allowed. As to the Government's motion, we do not think the opinion contains factual errors. Plaintiff's latest position, relating to the possible applicability of section 1052(a), Internal Revenue Code of 1954, could have been raised by way of response to the Government's moving brief, which clearly suggests the reasoning of our decision. In these circumstances post-decision relief will be rejected. *General Elec. Co.* v. *United States*, 189 Ct. Cl. 116, 117–18, 416 F. 2d 1320, 1321–22 (1969)."

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524 F. 2d 1155

# PENN SECURITY LIFE INSURANCE COMPANY v. THE UNITED STATES

[No. 109–68. Decided October 22, 1975]

ON THE PROOFS

**Taxes; income tax; qualification as life insurance company; reserve ratio test; double deduction.**—Plaintiff, incorporated under the statutes of Missouri, seeks to recover Federal income taxes and interest for calendar years 1963, 1964 and 1965. During those years plaintiff's business consisted primarily of reinsuring risks written by three unrelated insurance companies under credit life, accident and health policies on the lives and health of debtors of plaintiff's parent company. Under its reinsurance treaties with the ceding companies, plaintiff agreed to reinsure 100% of the liability of each ceding company with respect to disability benefits included in credit life policies issued to said parent and its borrowers. The treaties provided that the monthly reinsurance premiums were payable to plaintiff only after they had been earned by plaintiff, not in advance. The Commissioner of Internal Revenue determined that plaintiff was not a "life insurance company" as defined in Sec. 801 of the 1954 Code. Additionally, plaintiff issued its own group annuity policy in 1965 to the trustee of a pension fund of the International Telephone Retirement Plan for Salaried Employees, and maintained a reserve with respect to its liabilities under this annuity contract, computing the amount of its reserve under Sec. 801(b)(5) requiring life insurance companies to use the mean of reserves held at the beginning and end of the year. Defendant recomputed the annuity reserves under Sec. 806(a) by adjusting them on a daily basis. It is *held* that plaintiff qualified during the years in issue as a life insurance company under Sec. 801. The court does not accept the rationale of the majority of the Court of Appeals in *Economy Finance Corp.* v. *United States*, 501 F. 2d 466 (1974), reversing the lower court's opinion, but accepts the reasoning of the lower court; (2) that as to the issue of requirements of state law, this case is disposed of on the reasoning in the court's opinion in *Consumer Life Ins. Co.* v. *United States, post* at 638; thus, since plaintiff received no unearned premiums from the ceding companies, it was not required by Missouri to establish an unearned premium reserve; (3) that the reserves held by plaintiff respecting the annuities purchased under the group annuity policy were properly computed using the mean of reserves held at the beginning and end of the year, and that Sec. 806(a) does not apply to reserves held under a newly issued policy by the original insurer; (4) that plaintiff's attempt to deduct under Sec. 809(d)(1) accrued and unpaid losses and also to deduct under Sec. 809(d)(2) an increase in reserve for unpaid losses is barred by Treas. Reg. § 1.809–5(b) as a double deduction. Plaintiff is entitled to recover consonant with the foregoing, with the amount of recovery to be determined in further proceedings under Rule 131 (c).

**Taxes; income tax; life insurance companies; judicial determinations.**

[1] In applying 26 U.S.C. § 801 to the present case, the court notes that it is addressed to technical specialists, i.e. actuaries, and hence its provisions must be read by judges with the minds of the specialists.

Internal Revenue ⚷ 122

**Taxes; income tax; assessments; method of and time for assessment.**

[2] The filing of a suit in this court for refund of income taxes does

not affect the Commissioner's right, after expiration of the 90-day period for petitioning the Tax Court, to make an additional assessment for the same years involved in plaintiff's petition. Defendant was not required under Sec. 7422(e) to bring a counterclaim in this suit, since the wording of the section is permissive and not mandatory. Other methods may be used for collection of a tax, and the method of assessment in this instance was valid, since a separate collection suit would have to be based on a valid assessment.

Internal Revenue ⟾ 2050

**Taxes; income tax; life insurance companies; status of company as insurance company; reserve ratio test.**

[3] Where plaintiff's business consisted primarily of reinsuring risks written by three unrelated insurance companies under credit life, accident and health policies on the lives and health of debtors of plaintiff's parent company, and where, under plaintiff's reinsurance treaties with the ceding companies, it neither received nor had any right to receive "unearned premiums" because the treaties provided that the monthly reinsurance premiums were payable only *after* they had been earned by plaintiff, not in advance, the unearned premium reserves held by the ceding companies are not allocable to plaintiff as an element affecting its 50% reserve ratio, and consequently since plaintiff otherwise met the reserve ratio test it qualified as a life insurance company. An unearned premium reserve is required to be established only with respect to that portion of the reinsurance premium which has been received by the reinsurer prior to expiration of the period of coverage to which that premium relates. (*Economy Finance Corp.* v. *United States*, 501 F. 2d 466 (C.A. 7, 1974), *distinguished* and not followed.)

Internal Revenue ⟾ 826

**Taxes; income tax; life insurance companies; status of company as insurance company; congressional intent.**

[4] In enacting 26 U.S.C. § 801, Congress could have differentiated "life insurance companies" from others for tax purposes by selecting any of a number of measuring rods, but it chose a simple reserve ratio test which has the advantage of being hinged to the requirement of state authorities as to maintenance of adequate reserves. Since the legislative history does not indicate that Congress zeroed in on policies connected with underwriting income and probably did not intend to restrict the concept of "life insurance company" to those firms having a predominance of policies yielding deferrable underwriting income (Sec. 820), it is preferable for the court to accept the statute as written and apply the reserve ratio test which Congress has specified, leaving to Congress the function of closing loopholes (if they exist) or restructuring Sec. 801 in greater detail. If some anomalies exist under the statute as it stands, the Congress is in far better position to clarify its purpose and to harmonize Sec. 801 with the other provisions of the insurance portion of the Code.

Internal Revenue ⟾ 826

**Taxes; income tax; life insurance companies; life insurance reserves; change in reserves attributable to transfer of liabilities.**

[5] Where plaintiff-taxpayer issued its own group annuity policy to the trustee of a pension fund, the reserves held by plaintiff under the newly issued policy are properly computed using the mean of reserves held at the beginning and end of the year, and not by adjusting them on a daily basis as provided in Sec. 806(a) of the Code, since the annuity reserves were established as a result of liabilities incurred by plaintiff under its new policy and were not attributable to "liabilities" assumed by plaintiff under the pension plan.

Internal Revenue 🔑 826

**Trusts; liability of trustee.**

[6] It is hornbook law that a trustee is not an insurer but at most has the responsibility prudently to manage the trust funds in accordance with the purpose set forth in the trust instrument.

Trusts 🔑 270

**Taxes; income tax; life insurance companies; gain and loss from operations; deductions; double deduction; accrued and unpaid losses; increase in reserve for unpaid losses.**

[7] Where plaintiff insurance company deducted under Sec. 809(d)(1) of the 1954 Code the amount of its accrued and unpaid losses, it was not entitled to also deduct them under Sec. 809(d)(2) allowing a deduction for an increase in reserve for unpaid losses, since this would result in a double deduction prohibited by Treas. Reg. § 1.809-5(b).

Internal Revenue 🔑 603

**Taxes; Treasury Regulations; contruction and operation; generally.**

[8] Those who insist that a Treasury Regulation is invalid must make its invalidity so manifest that the court has no choice except to hold that the Secretary has exceeded his authority and employed means that are not at all appropriate to the end specified in the act of Congress.

Internal Revenue 🔑 151

*John B. Jones, Jr.*, for plaintiff; *Owen T. Armstrong*, attorney of record. *Lowenhaupt, Chasnoff, Freeman, Holland & Mellitz*, *Robert A. Kagan*, *John T. Sapienza*, *Andrew W. Singer*, and *Covington & Burling*, of counsel.

*Herbert Grossman*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Gilbert E. Andrews* and *Roger A. Schwartz*, of counsel.

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Before COWEN, *Chief Judge*, DAVIS, NICHOLS, SKELTON, KASHIWA, KUNZIG, and BENNETT, *Judges*.

PER CURIAM:* Section 801(a) of the Internal Revenue Code, as amended, defines a life insurance company in the following language:

> (a) Life Insurance Company Defined.—For purposes of this subtitle, the term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if—
>
> (1) its life insurance reserves (as defined in subsection (b)), plus
>
> (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, health, or accident policies not included in life insurance reserves,
>
> comprise more than 50 percent of its total reserves (as defined in subsection (c)).[1]

In *Alinco Life Insurance Company* v. *United States*, 178 Ct. Cl. 813, 373 F. 2d 336 (1967), the court addressed its attention to the question of whether an insurance company specializing in the reinsuring of *credit life* insurance could qualify as a life insurance company under Section 801, and held that it could, provided it met the 50 percent test. As might have been easily predicted, the question of life insurance company qualification is now back before the court with emphasis, however, on those provisions of Section 801 dealing, not with life insurance, but with health and accident insurance. In applying Section 801 to this case, we appreciate that the statute was *not* "written for ordinary folk * * *" It is addressed to technical specialists (*i.e.*, actuaries) and hence, its provisions "must be read by judges with the minds of the specialists." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COL. L. REV. 527, 536 (1947).

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*This opinion incorporates the opinion of Trial Judge Floyd Fletcher, with minor changes and some additions.

[1] Section 801 goes on to provide:

* * * * *

"(c) *Total Reserves Defined.*—For purposes of subsection (a), the term 'total reserves' means—

(1) life insurance reserves.

(2) unearned premiums, and unpaid losses (whether or not ascertained), not included in life insurance reserves, and

(3) all other insurance reserves required by law.

"The term 'total reserves' does not include deficiency reserves (within the meaning of subsection (b)(4))."

On balance, we have concluded that plaintiff-taxpayer has the better of the argument and qualifies as a life insurance company so that it is entitled to recover. To explain why requires, first of all, a description of the taxpayer's method of conducting its insurance business during the years in issue, namely, the calendar years 1963, 1964, and 1965.

In those years, plaintiff's business consisted primarily of reinsuring risks written by three unrelated insurance companies under credit life, accident and health policies on the lives and health of debtors of plaintiff's parent, Aetna Finance Company (Aetna). Aetna was engaged in the business of making consumer loans through subsidiaries operating over 200 finance company offices in approximately 25 states.

In connection with such loan transactions, it was commonplace for Aetna's borrowers to apply for and receive credit life insurance policies (or group insurance certificates), including health and accident benefits, from one of three insurance companies, namely, Old Republic Life Insurance Company (Old Republic), Pilot Life Insurance Company (Pilot), and National Fidelity Life Insurance Company (National Fidelity). Hereafter, these companies are frequently referred to as "the ceding companies," and plaintiff had separate disability reinsurance treaties in force with each of them during the years involved.

Under the life insurance provisions of these policies, the insurer was required to pay the creditor any outstanding balance of the debt in the event of the insured debtor's death. The health and accident provisions called for the insurer to pay debt installments falling due while the insured was totally disabled and unable to work. The terms of the policies (or group certificates) were coextensive with the contractual term of the related indebtedness, usually two to three years.

Under its reinsurance treaties with the ceding companies, plaintiff agreed to reinsure 100 percent of the liability of each ceding company with respect to disability benefits included in credit life policies issued to Aetna and its borrowers.

These treaties provided for payment of reinsurance premiums to plaintiff on a monthly earned premium basis; *i.e.*, a reinsurance premium was payable each month with respect to reinsurance coverage provided during the previous month based on a percentage of premiums "earned" on covered policies during that month.

All of the credit insurance policies issued by the ceding companies called for payment of insurance premiums (both a life insurance premium and, where applicable, a disability premium) at the inception of the policy term. When a disability premium is first received under such a policy, it is wholly "unearned" in the sense that the entire premium is attributable to the unexpired portion of the policy. As the term of the policy expires each month, a proportionate part of the premium becomes "earned"; *i.e.*, attributable to insurance protection provided during that month.

Thus, to use plaintiff's illustration, if a ceding company received a $360 disability premium on January 1, 1963, with respect to a policy providing insurance coverage for 36 months, one-thirty-sixth of this premium (or $10) would be considered "earned" during the month of January and each succeeding month. The "unearned" premium would be $350 at the end of January, $340 at the end of February, and so on. Under its disability reinsurance treaties, plaintiff was entitled to a monthly reinsurance premium equal to a percentage of the $10 "earned" premium for reinsurance coverage actually provided each month. The ceding companies retained all unearned premiums on policies covered under the disability reinsurance treaties and established an unearned premium reserve in the amount of such unearned premiums for the benefit of their policyholders in accordance with the applicable restrictions of state law and in satisfaction of the reserve requirements of the various states in which they did business.

Since plaintiff received no unearned premiums from the ceding companies, it was not required to establish an unearned premium reserve by the State of Missouri. No actuary or state regulatory authority required plaintiff to establish an unearned premium reserve under its disability reinsurance treaties with the ceding companies, since plaintiff never received premiums thereunder for insurance to be provided in the future or premiums which it might otherwise be required to refund.

Approximately two-thirds of the unearned premium reserves held by the ceding companies represented unearned "loading" charges made to cover profits and sales and office expenses. The remaining one-third of such unearned premium reserves represented unearned *net* premiums charged to policyholders to cover the expected cost of providing disability insurance benefits; this portion alone (known in the industry as the morbidity element) reflected the amount that the companies were actuarially required to hold in order to pay disability claims as they matured. Unearned loading charges are held as part of unearned premium reserves because the casualty insurance industry has traditionally determined its reserve requirements with regard to the full amount of premiums that would have to be refunded if all policies in force were simultaneously canceled instead of reserving only for the cost of carrying the insurance risk (the unearned *net* premiums) as in life insurance.

As insureds grow older, the mortality or morbidity costs increase and when an accident and health policy is written for a long term of years, the guaranteed level premium charged will not be sufficient to provide benefits after the insured reaches a specified age. In those instances, a reserve, in addition to the pro rata gross unearned premium reserve, is set up out of current premiums to provide for the excess of future benefits over future premiums. No such reserves were created by the three insurers with regard to the credit accident and health policies reinsured with taxpayer, presumably because such policies were relatively short-term.

In addition to its reinsurance treaties with the ceding companies during the years in issue, plaintiff also issued its own group annuity policy on December 22, 1965 (Group Annuity Contract No. 101) to the St. Louis Union Trust Company as trustee of Pension Fund No. 6 of the International Telephone Retirement Plan for Salaried Employees, which contract has remained outstanding and in effect to the present time. Plaintiff received securities valued at $5,929,057.24 for the purchase of single premium annuities under Group Annuity Contract No. 101 on or about December 22, 1965. Prior to this transaction, no group annuity or individual annuity contracts had been purchased by any trustee of any pension fund under the International Telephone Retirement Plan for Salaried Employees on the lives of the individuals covered under Group Annuity Contract No. 101.

Plaintiff maintained a reserve of $6,072,004 on December 31, 1965, with respect to its liabilities under Group Annuity Contract No. 101 on that date. Such reserve was computed on the basis of a recognized mortality table (1959 G.A.) and an assumed rate of interest (3½%), and was set aside to mature or liquidate future unaccrued claims arising under Group Annuity Contract No. 101.

On April 4, 1968, plaintiff filed a petition with this court seeking a refund of income taxes for the years in issue on the grounds, *inter alia*, that it was entitled to deduct accrued and unpaid losses under Section 809(d)(1) of the Code and to take such losses into account in determining the increase in its reserves for those years as provided in Section 809(d)(2) of the Code. On October 24, 1968, a notice of deficiency was mailed to plaintiff with respect to the years covered in plaintiff's petition. The deficiencies proposed therein were based upon the assertion that plaintiff did not qualify as a life insurance company during the years 1963, 1964, and 1965 under Section 801(a) of the Code, and upon that assertion, by an Amended Answer, defendant filed a counterclaim herein.

On February 14, 1969, after the time provided by statute for petitioning the Tax Court had expired but while plaintiff's tax liability for the years covered by the notice of deficiency was still before this court, the Commissioner of Internal Revenue assessed the amount of the asserted deficiencies in plaintiff's income tax, together with interest on such deficiencies, and demanded payment thereof. Plaintiff contested the validity of this assessment, but paid such amounts under protest on March 5, 1969. On March 30, 1970, plaintiff filed its First Amended Petition with this court seeking recovery of the amounts claimed in its original petition as well as the amounts of the asserted deficiencies paid on March 5, 1969. In its Answer to plaintiff's First Amended

Petition, defendant stated that "since the Plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund for these taxes, a counterclaim by the defendant is no longer necessary, nor required by law."

Plaintiff attacks the validity of the assessment described in the preceding paragraph. The argument is that, at a time when plaintiff had a refund suit pending in this court for the years 1963, 1964, and 1965, defendant determined additional deficiencies for those same years thus bringing into play the provisions of Section 7422(e) of the Internal Revenue Code. In pertinent part, that section reads as follows:

> (e) Stay of proceedings.—If the Secretary or his delegate prior to the hearing of a suit brought by a taxpayer in a district court or the Court of Claims for the recovery of any income tax, * * * mails to the taxpayer a notice that a deficiency has been determined in respect of the tax which is the subject matter of taxpayer's suit, the proceedings in taxpayer's suit shall be stayed during the period of time in which the taxpayer may file a petition with the Tax Court for a redetermination of the asserted deficiency, and for 60 days thereafter. If the taxpayer files a petition with the Tax Court, the district court or the Court of Claims, as the case may be, shall lose jurisdiction of taxpayer's suit to whatever extent jurisdiction is acquired by the Tax Court of the subject matter of taxpayer's suit for refund. If the taxpayer does not file a petition with the Tax Court for a redetermination of the asserted deficiency, the United States may counterclaim in the taxpayer's suit, * * * within the period of the stay of proceedings notwithstanding that the time for such pleading may have otherwise expired. The taxpayer shall have the burden of proof with respect to the issues raised by such counterclaim * * * of the United States except as to the issue of whether the taxpayer has been guilty of fraud with intent to evade tax.

Plaintiff asserts that the procedure prescribed in Section 7422(e) invalidates the assessment described above because the section must be read as calling exclusively for a counterclaim. While the argument is an ingenious one, we find it without merit.

First of all, it overlooks the permissive, as opposed to mandatory, wording of Section 7422(e) which merely states that the Government "may counterclaim in the taxpayer's suit." The effect of such language is explained in *Bar L Ranch, Inc.* v. *Phinney*, 400 F. 2d 90, 92 (5th Cir. 1968) as follows:

> In Flora v. United States, 1958, 362 U.S. 145, 80 S. Ct. 630, 4 L. Ed. 2d 623, the Supreme Court explained that when a taxpayer chooses to remain in the district court in a case similar to the instant case, "the Government may—but seemingly is not required to—bring a counterclaim; and if it does, the taxpayer has the burden of proof." This language indicates that the counterclaim is a permissive one, and that other methods may be used for the collection of the tax. Thus the Court assumed that any assessment of the tax would be valid since a separate collection suit would have to be based on a valid assessment. See also Florida v. United States, 8th Cir. 1960, 285 F. 2d 596.

The Circuit Court then went on to hold that an assessment, in essence similar to the one disputed here, was valid.

Secondly, plaintiff apparently would ignore the limitations provisions contained in Section 6501 of the Code. That section requires the Government to assess "within 3 years after the return was filed * * *" By Section 6501(c) (4) that period may be extended by mutual consent of the taxpayer and the Government, a procedure presumably well known to the able and sophisticated tax counsel for this plaintiff. No effort is made to explain why this was not done in the present case.

However, lastly and in all events, the decision for plaintiff on the merits, as below, would seem to render this procedural point moot.

### *The Section 801 Issue*

Turning to the merits, it is necessary at the outset to determine whether plaintiff, under Section 801 of the Internal Revenue Code, qualifies for taxation as a life insurance company. As was pointed out in *Alinco*, *supra* at 838, 373 F. 2d at 350, the qualification formula in Section 801 may be expressed in terms of the following fraction, the quotient of which must be more than 50 percent in order for an insurance company to qualify as a life insurance company:

| Qualifying reserves (numerator) | ÷ | Total reserves (denominator) |
|---|---|---|
| 1. Tabular reserves on life, annuity, and noncancellable accident and health policies | | 1. Tabular reserves on life, annuity, and noncancellable accident and health policies |
| 2. Unearned premiums on noncancellable life, health, or accident policies not included in (1) | | 2. Unearned premiums not included in (1) |
| 3. Unpaid losses on noncancellable life, health, or accident policies not included in (1) | | 3. Unpaid losses not included in (1) |
| | | 4. All other insurance reserves required by law. |

If one goes no further than plaintiff's own books and records, it is clear from the figures set out in finding 14, *infra*, that plaintiff's quotient (or reserve test ratio, it is frequently called) exceeded 50 percent in each taxable year. Defendant does go further, however. Using a process somewhat reminiscent of a Section 482 allocation of income between related corporations, defendant would allocate or, to use its word, attribute to plaintiff the unearned premium reserves of the ceding companies established by them with respect to their disability policies reinsured by plaintiff. Defendant justifies this attribution upon the theory that reserves must follow the risk and, by increasing the denominator of the above fraction, the effect is to decrease plaintiff's reserve test ratio below 50 percent in each year.

Plaintiff, of course, objects vigorously to this attribution to it from unrelated companies of unearned premium reserves which it was not required to hold, had no right to hold, and did not in fact hold. It points out that, under its reinsurance treaties with the ceding companies, plaintiff neither received nor had any right to receive "unearned premiums" as that term is defined in Treas. Reg. Section 1.801-3(e),[2] because those treaties provided that the monthly reinsurance premiums were payable only *after* they had been earned by plaintiff, not in advance. Plaintiff is correct in these contentions.

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[2] The regulation states that the term "means those amounts which shall cover the cost of carrying the insurance risk *for the period for which the premiums have been paid in advance* * * *." (Emphasis supplied.)

Presented with a credit reinsurance arrangement essentially identical to the present case, the U.S. District Court for the Southern District of Indiana held for the taxpayer. *Economy Finance Corp.* v. *United States*, 30 AFTR 2d 72-5446 (July 25, 1972), rev'd, 501 F. 2d 466 (7th Cir. 1974), *cert. denied*, 420 U.S. 947 (1975). There, as here, the Government sought to disqualify from life insurance company status reinsurers by adding "unearned premiums" held by a ceding company to their "total reserves." Again like the present case, the reinsurance treaties provided for payment of the reinsurance of credit accident and health risks on a monthly earned premium basis. The District Court found that such "reinsurance on a month-to-month basis is not an uncommon or unaccepted reinsurance arrangement" and in a comprehensive and well-reasoned opinion refused to attribute the ceding company's unearned premium reserves to the reinsurer. 30 AFTR 2d at 72-5451. In this respect, the court found the mode of premium payment conclusive, saying:

> * * * An unearned premium reserve is required to be established only with respect to that portion of the premium (or reinsurance premium) which has been received by the insurance company prior to the expiration of the period of coverage to which that premium relates. An insurance company is not required to establish an unearned premium reserve with respect to premiums or reinsurance premiums to be received in the future. Since under the terms of the accident and health Reinsurance Treaties reinsurance premiums were due from Standard Life to National Life and United Life only in the month succeeding the month for which the two reinsurers assumed the risk on the credit accident and health insurance policies issued by Standard Life, those reinsurance premiums were fully earned when received. It therefore would have been improper for National Life or United Life to establish any unearned premium reserve. Since National Life and United Life received only reinsurance premiums which represented payments for the assumption of insurance risks by those companies which had already expired by each reserve date, they were not required to set up unearned premium reserves. No state regulatory agency would have required National Life or United Life to set up unearned premium reserves with respect to the credit accident and health insurance which was issued by Standard Life and reinsured by National

> Life and United Life. Even without the cancellation provisions in the credit accident and health Reinsurance Treaties, it would not have been proper for National Life or United Life to set up unearned premium reserves since under the terms of those treaties they reinsured risks on a month-to-month basis. Since under the terms of the credit accident and health Reinsurance Treaties National Life or United Life were given the right to cancel the treaties upon giving 30 days' notice, in which event they would have been subject to only a limited amount of liability on policies then in force, an additional reason exists for their not being required to establish unearned premium reserves.

30 AFTR 2d at 72-5452.

We agree with the District Court's reasoning and result. The Seventh Circuit reversed the District Court but we cannot accept the rationale of the majority of the Court of Appeals. It should be noted, first, that the facts in *Economy Finance Corporation* differed from those in the present case in one important respect. Those taxpayers had agreements with the ceding company under which the latter was required to invest most of the unearned premium reserves in subordinated debentures of the parent of one of the taxpayers, and then to turn over the interest income received on those debentures as an "additional commission" to the insurance agency partnership composed of stockholders of one of the related taxpayers. *See* 501 F. 2d at 470. Thus, the *Economy Finance* taxpayers in effect received the proceeds of the unearned reserves even while in the hands of the ceding company. That arrangement was quite different from the one involved in the case at bar and could be understood as making that ceding company the agent of those taxpayers.

But the Court of Appeals, though it referred to that side-arrangement (*see* 501 F. 2d at 471 n. 5, 477), did not center its decision thereon. Recognizing that the literal terms of § 801 favor the taxpayer (501 F. 2d at 477), the Court of Appeals refused to apply the statute as written because, in its view, that interpretation failed to further Congress's purpose in giving special tax treatment to life insurance companies. That dominant objective the Seventh Circuit took to be the legislative desire to postpone half of the tax on investment income which accrues with respect to much life insurance and which cannot be accurately determined "until the life contract has been completely performed." *See* 501 F. 2d at 474, 476–77. Since such investment income is not a factor for the health and accident policies involved in *Economy Finance* and here, the court considered that it would distort the Congressional purpose to allow those policies to be taken into account (without offsetting reserves) in determining whether the companies are entitled to "life insurance company" treatment.

We are far less certain than the Seventh Circuit that this was Congress's overriding aim. Section 801 is a technical provision, carefully worked out in some detail over the years. As Circuit Judge Stevens pointed out in dissent in the *Economy Finance* case, Congress could have differentiated "life insurance companies" from others for tax purposes by selecting any of a number of measuring rods, but it chose a simple reserve-ratio test which has the advantage of being hinged to the requirements of state authorities as to the maintenance of adequate reserves. 501 F. 2d at 483. The legislative history does not indicate that Congress zeroed in on policies connected with underwriting income. Indeed, the reserve-ratio criterion was initially selected by Congress decades before the enactment of the current provisions for deferring part of the underwriting gain, at a time when Congress viewed premium receipts as not taxable because not true income but rather as analogous to permanent capital investment. *See Helvering* v. *Oregon Mutual Life Ins. Co.*, 311 U.S. 267, 268–69 (1940); *Alinco Life Ins. Co.* v. *United States supra* at 831, 373 F. 2d at 346. Moreover, Congress imposed statutory limits on the amount of deferrable underwriting income (*see* § 815(d)(4)), and there is no certainty that a company qualified as a "life insurance company" would be able to take full advantage of that privilege, perhaps not at all.

Still another indication, in our view, that Congress probably did not intend to restrict the concept of "life insurance company" to those firms having a predominance of policies yielding deferrable underwriting income is the Code's treatment of "modified coinsurance." In that situation the ceding company holds the reserves on reinsured risks, but also pays over the investment income from the reserve to the reinsurer.

Congress has provided in § 820 that the reinsurer may, though it need not, take the ceding company's reserve into account but only if both parties consent to this treatment. *See also* Rev. Rul. 70-508, 1970-2 C.B. 136. As taxpayer points out, this would result in the anomaly, under the Seventh Circuit's opinion, that a reinsurer may successfully avoid attribution if it has the ceding company pay over gross investment income from the reserve, but must accept attribution when the ceding company not only holds the reserve but keeps the investment income. Defendant's response is that § 820 does not relate to qualification as a "life insurance company" but only to the determination of taxable-investment income and gain, once qualification has been established. This is true but does not destroy the point that it is doubtful that Congress gave special treatment to life insurance companies primarily because of their underwriting income.

In addition, the consequences of the general rule laid down by the Court of Appeals are uncertain and unclear. Judge Stevens thought the majority's standard might well exclude from coverage under § 801 such a common form of life insurance as term insurance. *See* 501 F. 2d at 486 n. 7. There may be other untoward gaps or disharmonies. We cannot tell because the consequences of departing from the text of § 801 are opaque.

In these circumstances, it seems to us preferable to accept the statute as written, leaving to Congress the function of closing loopholes (if they exist) or restructuring the provision in greater detail. The section is technical and specific, directed to a complicated but very narrow segment of the law. If there be some anomalies under the statute as it stands, the Congress is in far better position to clarify its purpose and to harmonize § 801 with the other provisions of the insurance portion of the Code. Though there may be some results which can be questioned on economic or actuarial grounds, the literal words of the section do not produce absurd results, or results which one can say are clearly contrary to the legislative purpose. *Cf. United States* v. *Olympic Radio & Television Co.*, 349 U.S. 232, 236 (1955). We agree therefore with Circuit Judge Stevens, dissenting in *Economy Finance* (501 F. 2d at 485): "* * * the government's conclusion that life insurance represents less than half of taxpayers' total insurance business rests on a non-statutory standard. Congress may have acted unwisely in giving preferential tax treatment to life insurance companies, and it may have been unwise to select a reserve-ratio test as the definition of a life insurance company for tax purposes. Nevertheless, we must, of course, apply the test which Congress has specified."

Defendant also urges that a different result is called for by a recent decision by the Fourth Circuit Court of Appeals in *Superior Life Insurance Company* v. *United States*, 462 F. 2d 945 (4th Cir. 1972). In our view, defendant's reliance on that case is entirely misplaced. *Superior Life* did not involve reinsurance. The unearned premiums there involved were collected and held by the taxpayer's parent company (a finance company, not an insurer) under a group insurance policy issued by the taxpayer. The parent acted merely as the taxpayer's agent and "in reality the fund in [the parent's] hands was subject to being used to pay taxpayer's obligations and for the benefit of taxpayer whenever taxpayer so desired." *See Superior Life Ins. Co.* v. *United States*, *supra*, at 950. None of the facts on which the decision in *Superior Life* turned—(1) the agency relationship between the holder of the premiums and the insurance company, (2) the free availability of the unearned premiums to the insurance company, and (3) identity of control between the parent-agent and subsidiary-insurance company—is present here. Since the taxpayer in *Superior Life* "constructively received" unearned premiums under long-accepted principles of tax law, the Fourth Circuit's decision is entirely consistent with the fact that the existence of unearned premium depends upon the mode of premium payment.

On this phase of the case, mention should be made of plaintiff's argument that defendant's "reserves follow the risk" rule has been recently rejected by this court in *Title Guarantee Co.* v. *United States*, 193 Ct. Cl. 1, 432 F. 2d 1363 (1970). Defendant continues to urge, however, that the earlier decision of *Colonial Surety Co.* v. *United States*, 147 Ct. Cl. 643, 178 F. Supp. 600 (1959), established a "reserves follow the risk" rule for tax purposes. But in *Title Guaran-*

*tee* the court rejected that argument and distinguished the *Colonial Surety* case as follows:

> * * * The plaintiff [in the *Colonial Surety* case] sought to deduct *unearned commissions and not unearned premiums.* * * *
>
> The government argues that the portion of the trust fund attributable to the parts of the policies reinsured should not be considered as unearned premiums * * * for the reason that the taxpayer is no longer carrying the risk on the parts reinsured. *We cannot accept this theory.* Even though plaintiff has obtained reinsurance, it is still liable to the policyholder in case of loss and is, therefore, still carrying the risk despite the reinsurance.

*Title Guarantee Co.* v. *United States, supra*, 193 Ct. Cl. at 25, 432 F. 2d at 1376. (emphasis added).

Finally, at a later stage in this litigation the court itself injected an issue which had not been presented to the trial judge or to the three-judge panel of the court which first heard the argument. As a result of the decision by a different trial judge in *Consumer Life Ins. Co.* v. *United States*, No. 463–70, the court ordered the parties to brief and argue the question of whether *state law* required the taxpayer to establish an insurance reserve for the unearned premiums involved here (if so the case would be governed by Section 801(c)(3), *supra* note 1, and the taxpayer would lose). The case was then ordered to be heard en banc.[3] It has since been held awaiting the decision in *Consumer Life Ins. Co.* which was argued somewhat later. That case is also being decided today, and on the new issue of the requirements of state law we dispose of this case on the reasoning of the court's opinion in *Consumer Life*—Missouri law did not require taxpayer to establish reserves for the premiums involved here.[4]

From all the foregoing, it is concluded that defendant's attempt to attribute to plaintiff the unearned premiums reserves actually held by the ceding companies is incorrect.

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[3] This was done before the three-judge panel had rendered its decision.

[4] *See* Findings of Fact 19, 20, 21, 22, 28, and especially 29 *infra*. Defendant relies mainly on *Vernon's Annotated Missouri Statutes* § 376.410(1), (3), and (4), but the text of those provisions fully harmonizes with the interpretation of Missouri law spelled out in our findings and followed by the Missouri insurance administrators, *i.e.*, that Missouri law did not during the years in question require this taxpayer to set up the reserves in question.

Accordingly, plaintiff's reserve test ratio for 1963 was 68.50 percent, for 1964 was 54.48 percent, and for 1965 was 85.76 percent. *See* finding 14, *infra.* Therefore, plaintiff qualified in those years as a life insurance company under Section 801, and it is unnecessary to reach alternative arguments made by counsel for the parties.

### *Plaintiff's Group Annuity Policy No. 101*

On December 22, 1965, plaintiff issued its own group annuity policy No. 101 to the St. Louis Union Trust Co. as trustee of Pension Fund No. 6 of the International Telephone Retirement Plan for Salaried Employees. At December 31, 1965, plaintiff's reserve held with respect to annuities purchased under this policy was $6,072,004. In computing the amount of its reserves under Section 801(b)(5) which requires life insurance companies to use the mean of reserves held at the beginning and end of the year, plaintiff included $3,036,002 (0+$6,072,004÷2) with respect to this annuity policy.

Defendant recomputed the annuity reserves under Section 806(a) by adjusting them on a daily basis. This adjustment was accomplished by applying a fraction to the reserve, the numerator of which was the number of days during the year in which the reserve was held and the denominator of which was the number of days in the year, and the result was to reduce plaintiff's year-end reserve to $502,156. Claiming this adjustment to be entirely erroneous, plaintiff asserts that neither the language nor the purpose of Section 806(a) covers reserves held under a newly issued policy by the original insurer, as was the case of Annuity Policy No. 101. Section 806(a) reads:

> For purposes of this part, if, during the taxable year, there is a change in life insurance reserves attributable to the transfer between the taxpayer and another person of liabilities under contracts taken into account in computing such reserves, then, under regulations prescribed by the Secretary or his delegate, the means of such reserves, and the mean of the assets, shall be approximately adjusted, on a daily basis, to reflect the amounts involved in such transfer. This subsection shall not apply to reinsurance ceded to the taxpayer or to another person.

Plaintiff argues that this section was designed by Congress exclusively to deal with acquisitions of reserves by one insurance company from another insurance company in those cases (commonly referred to as "assumption reinsurance") where the acquiring company becomes solely liable in place of the transferor company on the insurance contracts under which the acquired reserves are held. Clearly this did not occur in the present case, and the argument is that, therefore, Section 806(a) cannot apply but instead the more general averaging provisions of Section 801(b)(5) govern.

From the admittedly rather sparse legislative history, plaintiff would seem to be correct in this contention. For example, the following appears in S. Rep No. 291, 86th Cong., 1st Sess. 51 (1959) (1959–2 C.B. 807):

> * * * Subsection (a) of your committee's new section 806 relates to situations where there is a change in life insurance reserves (either increases or decreases) attributable to the transfer of liabilities under contracts taken into account in computing such reserves. This occurs, for example, when life insurance company I purchases all or a part of the business of life insurance company X under an arrangement (sometimes referred to as "assumption reinsurance") whereby company I becomes solely liable to the policy holders. Both I and X will have to make the adjustments provided by subsection (a).

The illustration which follows the above excerpt, as well as the examples given in Treas. Reg. Section 1.806–3(a), all deal with transactions and transfers between insurance companies.

Defendant agrees that the examples cited all illustrate transfers between insurance companies but counters with the observation that the regulations and Committee Reports do not specifically limit the section in the manner contended for by plaintiff and points to the language of the statute which covers transfers "between the taxpayer and *another person.*" (emphasis supplied.) If Congress intended to limit the applicability of Section 806(a) to transfers between insurance companies, defendant suggests it would have used the phrase "insurance company" instead of the word "person." This is an appealing argument, but, in our view, it is clearly offset by plaintiff's rational rejoinder that Congress used the term "person" with a view to reaching all acquisitions of reserves under *pre-existing insurance* contracts, including those in which the transferor may not qualify as an insurance company for *tax purposes*, and not to require a special adjustment of reserves when a *new* policy is issued to the trustee of a pension plan, such as St. Louis Union Trust Co.

Plaintiff also seems on sound ground in contending that the inapplicability of Section 806(a) to the issuance of a new insurance contract is manifest in defendant's inability to show here any "liabilities" on the part of the transferor, any "transfer" of such "liabilities," and any reserves computed on the basis of the transferor's "liabilities." It is not disputed that under the IT&T pension plan the employer had no liability for the payment of benefits nor that under the trust agreement the trustee was not liable for losses other than those resulting from its own neglect.

Nonetheless, says defendant, their fiduciary duties and obligations under the plan constituted "essentially an insurance function." However, as plaintiff observes, this misconceives the nature of the fiduciary relationship. It is hornbook law that a trustee is not an insurer but at most has the responsibility prudently to manage the trust funds in accordance with the purpose set forth in the trust instrument. *See* 3 SCOTT on TRUSTS § 204 (3d ed. 1967).

Finally, it can hardly be disputed that the annuity reserves in question were established as a result of liabilities incurred by plaintiff under its annuity policy No. 101 and were not attributable to "liabilities" assumed by plaintiff under the pension plan or the trust agreement. Hence, Section 806(a) does not apply.

### *The Unpaid Losses Deduction Issue*

It is not disputed that in computing its "gain from operations" as defined in Section 809(b), plaintiff was entitled to a deduction under Section 809(d)(1) for accrued and unpaid losses of $120,596 in 1963, $55,605 in 1964, and $30,000 in 1965. The present problem arises because plaintiff asks to deduct them again under Section 809(d)(2) which allows a deduction for an increase in certain reserves, including the reserve for unpaid losses. If this were permitted, the Government contends that the same item would be deducted twice in violation of Section 818(f) which reads:

> (f) *Denial of double deductions.*—Nothing in this part shall permit the same item to be deducted more than once under subpart B and once under subpart C.

The Government also points to Treas. Reg. Section 1.809-5(b) which expressly bars the double deduction of unpaid losses and an increase in unpaid loss reserves in the following language:

> (b) *Denial of double deduction.* Nothing in section 809(d) shall permit the same item to be deducted more than once in determining gain or loss from operations. For example, if an item is allowed as a deduction for the taxable year by reason of its being a loss incurred within such taxable year (whether or not ascertained) under section 809(d)(1), such item, or any portion thereof, shall not also be allowed as a deduction for such taxable year under section 809(d)(2).

There can simply be no doubt that the example given in the above regulation specifically proscribes the 809(d)(2) deduction here claimed by plaintiff. Therefore, to hold for plaintiff would necessarily require a determination that the regulation is invalid, and such a determination is not permissible in our view.

Plaintiff has made no showing that the departmental construction exemplified in this regulation is so unreasonable as to require a holding of invalidity, and long ago the Supreme Court had the following to say in *Boske* v. *Comingore*, 177 U.S. 459 at 470 (1900):

> Those who insist that * * * a regulation is invalid must make its invalidity so manifest that the court has no choice except to hold that the Secretary has exceeded his authority and employed means that are not at all appropriate to the end specified in the act of Congress.

Plaintiff's heavy reliance on *Title Guarantee*, *supra*, is misplaced, for there the court was not confronted with the necessity of holding a regulation invalid. Hence, as to this issue it is our view that the Government's position is correct.

Since, however, plaintiff should prevail on other remaining issues, as discussed above, it is entitled to recover with the amount thereof to be determined in further proceedings under Rule 131(c).

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NICHOLS, *Judge*, dissenting:

Upon a careful reading of *Economy Finance Corp.* v. *United States*, 501 F. 2d 466 (7th Cir. 1974), *cert. denied*, 420 U.S. 947 (1975), I find it applies the text in IRC § 801 (a), defining a Life Insurance Company in a sound and persuasive fashion. To avoid needless expansion of these remarks, I incorporate herein the analysis of the panel majority by reference so far as pertinent here. Were they less convincing than they are—unless plainly wrong—our respect for *stare decisis* and our dislike for going into conflict with another court should have carried the day. The objectionable consequences of conflicting lines of decisions in Federal tax cases are fully set forth in the *Preliminary Report of the Commission on Revision of the Federal Court Appellate System*, App. IV. This deals with the "Relitigation Policy" attributed to defendant, but relitigation by diverse taxpayers pursuing a common scheme or plan of tax avoidance is just as objectionable.

Defendant, with the authority of the Seventh Circuit behind it, would "impute" to plaintiff reserves under H & A policies it has arranged to have ostensibly carried for it by others, though in reality it bears the risk of loss itself. When such reserves are so "imputed" the plaintiff fails to pass the 50% test and is not entitled to the special advantages enjoyed by life insurance companies. As the Seventh Circuit shows, non-imputation completely frustrates the purpose Congress has in mind in prescribing the test. The contrary view is simply another instance of stating: "we see what you mean, Congress, but you said it wrong." To a simple, uncomplicated mind, the imputation is fully justified by the ancient maxim: "*Qui facit per alium, facit per se.*" Plaintiff maintains the reserves for purposes of the 801 (a) test, though for no other purposes, because it has arranged, itself or through its affiliates, and using the economic leverage they jointly possess, to have these reserves available to satisfy the right the H & A policy holders possess to have their risks covered by legally acceptable reserves.

## FINDINGS OF FACT

The court, having considered the evidence, the decision and findings of Trial Judge Lloyd Fletcher, and the briefs and arguments of counsel, makes findings of fact as follows:

### *General Background*

**1.** Plaintiff was incorporated on August 8, 1955, under the statutes of the State of Missouri applicable to the organization of life insurance companies. It is empowered by its Articles of Incorporation and authorized by the insurance authorities of the State of Missouri to engage in the business of issuing contracts insuring or reinsuring against death or disability, and has carried on such business exclusively.

**2.** Plaintiff is a wholly owned subsidiary of ITT Aetna Corporation, a second tier subsidiary of International Telephone and Telegraph Corporation (IT&T). Prior to August 31, 1964, plaintiff's capital stock was owned by the Aetna Finance Company. On that date, Aetna Finance Company sold all of its assets (including plaintiff's stock) to IT&T, which subsequently transferred those assets to ITT Aetna Corporation as a contribution to capital. (References made hereafter to "Aetna" refer either to Aetna Finance Company and its subsidiaries (other than plaintiff) or ITT Aetna Corporation and its subsidiaries (other than plaintiff) as appropriate.) Aetna has at all relevant times been engaged in the business of making consumer loans through subsidiaries which, during the years in issue, operated over 200 finance company offices in approximately 25 states.

**3.** Plaintiff was originally incorporated under the name American Universal Life Insurance Company, and operated under this name during the years in issue. Its name was changed to ITT Life Insurance Company in 1966, to ITT Hamilton Life Insurance Company in 1967, and finally to Penn Security Life Insurance Company on December 29, 1972.

4. Plaintiff's principal business, until approximately 1966. consisted of reinsuring death and disability risks underwritten by unrelated insurance companies in respect of credit life insurance policies issued by those companies to Aetna and its loan customers. By 1967, plaintiff's volume of business increased to the point at which it became more profitable for it to write its own credit insurance policies than to reinsure other companies. Plaintiff today writes a complete portfolio of the standard forms of ordinary and term insurance contracts including individual and group life, accident and health, and surgical coverage, as well as credit insurance for borrowers and installment purchasers.

5. Credit life insurance is usually sold as part of another and more prominent transaction, namely, a loan of money or an installment sale of tangible personal property. Its primary function is to provide a sure, quick, and uncomplicated means for liquidating the balance due on the loan or installment sale in the event of the death of the borrower or purchaser and, where health and accident coverage is combined with credit life insurance to also pay the borrower's monthly installment while he is unable to work. It is generally written for a term which is coextensive with the contractual term of the related indebtedness. Occasionally a company may write a credit insurance policy with a term of as long as 5 years, but the average in the industry is two to three years in most instances.

6. Credit insurance may be written under an individual insurance policy issued directly to the insured debtor, or under a group policy, in which case the beneficiary-creditor is the policy holder and the individual insured debtor simply receives a certificate of insurance as evidence of coverage under the group policy. In either case, the creditor is the primary beneficiary to the extent of the unpaid balance of the indebtedness at the time of the insured debtor's death or disability.

7. Most of the credit insurance policies issued to Aetna and its loan customers during the years in issue (1963, 1964, and 1965) were written by three insurance companies: Old Republic Life Insurance Company, of Chicago, Illinois (Old Republic), Pilot Life Insurance Company of Greensboro,

North Carolina (Pilot), and National Fidelity Life Insurance Company of Kansas City, Missouri (National Fidelity). (Old Republic, Pilot, and National Fidelity are hereinafter sometimes referred to as "the ceding companies"). To a much lesser extent, credit insurance policies were also issued to Aetna and its loan customers by Insurance City Life Company (Insurance City) and the American Bankers Life Assurance Company of Florida (American Bankers). Plaintiff had reinsurance agreements or "treaties" in force with each of the above companies during the years in issue.

8. All credit life insurance policies and certificates issued by the ceding companies to Aetna and its loan customers provided for the payment of the entire premium (including the disability premium where accident and health coverage was included in the policy or certificate) at the inception of the policy term. When a disability premium under a single premium policy is first paid by the insured, it is wholly "unearned," in the sense that the entire premium is attributable to the unexpired portion of the policy. As the term of the policy expires with the passage of time, a proportionate part of the premium becomes "earned;" *i.e.*, attributable to insurance protection provided during the expired portion of the policy.

9. Unlike insurance such as fire, public liability, and similar types of casualty insurance, credit life insurance contracts, including those reinsured by plaintiff (both with and without disability benefits), cannot be canceled by the insurer during the term for which they are written. However, the policies issued by the ceding companies to Aetna and its loan customers typically provided that insurance thereunder would terminate prior to the end of the term of the policy (usually, the maturity date of the indebtedness): (1) by renewal, refinancing, or repossession of the collateral for the indebtedness in connection with which the insurance was issued, (2) upon discharge of such indebtedness by payments by or on behalf of the debtor to the creditor, (3) by the indebtedness or any portion thereof being charged off or being required to be charged off by the laws applicable to the creditor, and (4) by cancellation of the insurance by the insured debtor. Under any of these circumstances, the

policy typically provided for a refund of the unearned portion of premiums paid by the insured debtor in accordance with a prescribed formula, usually the Rule of 78.

**10.** Under the Rule of 78 or "sum-of-the-digits" method, the unearned premium is computed by applying changing fractions each year (or month, if unearned premiums are determined monthly) to the premium paid by the insured. The numerator of the fraction changes each year (or month) to a number which corresponds to the sum of the digits of the remaining unexpired term (years or months) of the policy, and the denominator, which remains constant, is the sum of all the years' (or months') digits corresponding to the entire term of insurance coverage. For example, if an insured debtor paid a \$300 premium for disability benefits at the inception of a three-year single premium policy, he would be entitled to a refund under the Rule of 78 of \$300 $\left(\frac{3+2+1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the first year, \$150 $\left(\frac{2+1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the second year, and \$50 $\left(\frac{1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the third year.

**11.** The casualty insurance industry has historically viewed the unearned premium reserve as that portion of premiums paid by policyholders that is attributable to the unexpired terms of outstanding policies and that would have to be refunded to policyholders if all policies in force were to be canceled as of the statement date. The concept of an unearned premium serves several functions with respect to accident and health insurance. Primarily, the unearned net premium represents funds that must be held to provide the cost of the insurance risk which has not yet expired proportionate to the period for which premiums have been paid in advance. Unearned loading charges, which are obtained by subtracting the unearned net premium from the total unearned gross premium reserve, constitute a solvency reserve for the payment of refunds and future expenses. Unearned premium reserves maintained by the ceding companies on credit accident and health insurance covering debtors of Aetna were computed under the Rule of 78 method, the same method normally used in determining the required refund to policy holders in the event of a premature termination of a policy. One result of including unearned loading charges in the unearned gross premium reserve is a heavy charge to surplus which sometimes prevents the ambitious or over-rapid expansion of a company that might well result in its ultimate insolvency. Another result is that it imposes in an indirect manner additional capital requirements on companies having larger amounts of business in force.

**12.** Generally speaking, where insurance coverage is provided, the premium payable by the insured under the policy is due and payable at the outset of coverage. Whether this requirement obtains as between a ceding company and its reinsurer company depends on the provisions of the reinsurance treaty between them.

**13.** More than half of the dollar value of benefits reinsured by plaintiff during the years in issue under its treaties with the above companies were life insurance benefits. Some of the policies covered under plaintiff's reinsurance treaties were credit life insurance policies providing only death benefits. The remaining policies were credit life insurance policies combined with accident and health coverage, but the latter coverage never exceeded the amount of life insurance benefit provided under the policy (normally, the amount of the loan). With but one exception, none of the covered policies provided only credit accident and health insurance.

### *The Life Insurance Company Issue*

**14.** For each of its taxable years ended December 31, 1963, 1964, and 1965, the mean of plaintiff's life insurance reserves at the beginning and end of each year comprised more than 50 percent of the mean of its total reserves at the beginning and end of each year, as such reserves were reported on the annual statements submitted by plaintiff to the Missouri Division of Insurance and on the income tax returns filed by plaintiff for those years. The ratio of plaintiff's life insurance reserves to its total reserves under plaintiff's view of the case and as computed on its income tax returns for 1963, 1964, and 1965 was as follows:

| | *Jan. 1, 1963* | *Dec. 31, 1963* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | $556, 923. 00 | $733, 027. 00 | $644, 975. 00 |
| Total Reserves | 790, 108. 00 | 1, 092, 918. 49 | 941, 513. 28 |
| Reserve Test Ratio (1÷2) | | | 68. 50% |

| | *Jan. 1, 1964* | *Dec. 31, 1964* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | 733, 027. 00 | 806, 698. 00 | 769, 862. 50 |
| Total Reserves | 1, 092, 918. 49 | 1, 733, 125. 97 | 1, 413, 022. 23 |
| Reserve Test Ratio (1÷2) | | | 54. 48% |

| | *Jan. 1, 1965* | *Dec. 31, 1965* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | 806, 698. 00 | 7, 037, 233. 00 | 3, 921, 965. 50 |
| Total Reserves | 1, 733, 125. 97 | 7, 413, 108. 58 | 4, 573, 117. 28 |
| Reserve Test Ratio (1÷2) | | | 85. 76% |

**15.** The determination of the Commissioner of Internal Revenue that plaintiff was not a "life insurance company" as defined in Section 801 of the Code in 1963, 1964, and 1965 was based upon his inclusion in plaintiff's "total reserves" of unearned gross premiums actually held by the ceding companies (*i.e.*, Old Republic, Pilot, and National Fidelity) in respect of disability benefits under credit life insurance policies (combined with health and accident insurance) issued by those companies to Aetna and its loan customers. The amounts of "unearned premiums" added by the Commissioner of Internal Revenue to plaintiff's "total reserves" as of December 31, 1962, 1963, 1964, and 1965 were as follows:

*Unearned Premiums Attributed to Plaintiff*

| *From* | *Dec. 31, 1962* | *Dec. 31, 1963* | *Dec. 31, 1964* | *Dec. 31, 1965* |
|---|---|---|---|---|
| Old Republic | $183, 342 | $147, 375 | $145, 833 | $191, 416 |
| Pilot | 728, 821 | 782, 726 | 724, 445 | 829, 480 |
| National Fidelity | 413, 973 | 495, 288 | 570, 083 | 773, 670 |
| Total | 1, 326, 635 | 1, 425, 389 | 1, 440, 351 | 1, 794, 566 |

The Government now concedes that unearned premiums under the Old Republic Disability Reinsurance Treaty are not attributable to taxpayer for purposes of qualification as a life insurance company.

**16.** The unearned premiums attributed to plaintiff by the Commissioner of Internal Revenue as of December 31, 1962, 1963, 1964, and 1965 were actually held by the ceding companies on those dates and were included in the unearned premium reserves shown on the annual statements which they submitted to the insurance authorities of the various states in which they did business. In recognition of their continuing obligations to their policyholders, the ceding companies were required, both from an actuarial standpoint and under state law, to establish such unearned premium reserves while they actually held the unearned premiums in order to have funds available to pay claims and refunds to their policyholders and to reflect the fact that they had received premiums from policyholders for insurance protection to be provided after the statement date. The annual statements of those companies, in which the unearned premiums which the Commissioner of Internal Revenue now seeks to include in plaintiff's reserves were shown as unearned premiums of the ceding companies, were accepted by the insurance authorities in all the states in which the ceding companies did business.

The ceding companies maintained the unearned premiums attributed to plaintiff along with their other reserve funds in accordance with the applicable restrictions of state law, and they received the proceeds from their investments of such funds (interest, dividends, etc.) as their own income. Plaintiff did not obtain or use the unearned premiums reflected in the annual statements of the ceding companies, nor were such unearned premiums credited, set apart or made available to plaintiff. None of the ceding companies was owned or controlled, directly or indirectly, by plaintiff, Aetna, or IT&T.

17. The health and accident portion of the combined policies or certificates issued in connection with group policies were entirely separate insurance contracts which set forth a separate health and accident premium. However, it has been stipulated that credit accident and health insurance was never in fact sold without credit life insurance coverage and, except in one state, the two coverages were never sold as separate contracts. The life insurance reserves maintained by taxpayer on the life coverage were calculated without regard to any health and accident coverage written in combination therewith; conversely, the ceding companies ignored any combined life insurance coverage when they calculated and set up unearned premium reserves on the health and accident coverage.

18. Plaintiff had separate reinsurance treaties covering life insurance risks and disability insurance risks with each of the ceding companies during the years in issue. Under the disability reinsurance treaties, plaintiff agreed to reinsure 100 percent of the liability of each ceding company with respect to disability benefits included in credit life insurance policies issued to Aetna and its loan customers. The treaties provided for payment of a monthly reinsurance premium equal to 98 percent (89 percent under the Old Republic treaty) of the premiums earned with respect to credit accident and health insurance in force during the previous month. The following excerpts from the Pilot treaty are typical:

> Article I.
>
> * * * Pilot Life agrees to reinsure with [Taxpayer] one hundred per cent (100%) of the total of all Credit Accident and Health issued by Pilot Life covering the debtors of Aetna Finance Company. * * *, and [Taxpayer] agrees to accept such reinsurance automatically.
>
> Article II.
>
> 1. The liability of [Taxpayer] on all reinsurances shall begin simultaneously with that of Pilot Life and in no event shall the reinsurance of [Taxpayer] be in force and binding unless the policy issued by Pilot Life is in force.
>
> 2. In all reinsurances the liability of [Taxpayer] shall cease when the liability of Pilot Life ceases.
>
> * * * * *
>
> Article III.
>
> 1. Reinsurance payments to [Taxpayer] shall be made on or before the twenty-fifth of each calendar month, on a monthly term basis, based on all accident and health insurance in force during the previous month on policies reinsured with [Taxpayer].
>
> 2. The premium payable in any month shall be ninety-eight per cent (98%) of the earned premiums the previous month for all accident and health policies reinsured hereunder. Earned premiums for any month on such policies are all premiums written during such month, less returned premiums on such policies during such month, plus unearned premium reserves on such policies at the beginning of the month, and less the unearned premium reserves on such policies at the end of such month.

3. From the reinsurance premium due [Taxpayer] shall be deducted and withheld by Pilot Life:

A. The following expenses which are assumed by [Taxpayer]:

(1) All premium, occupational and privilege taxes applicable to the insurance.

(2) The cost of policy forms.

(3) Any special claim expense incurred by Pilot Life in accordance with Section 3 of Article IV hereof, and

(4) Any commissions paid to or retained by agents for writing the insurance; and

B. The total of all claims paid under reinsured policies during the period for which the premium is due.

4. If, at the time established for making any premium remittance, the total of the deductions listed in the preceding Section of this Article exceeds ninety-eight per cent (98%) of the earned premium for the period covered, [Taxpayer] shall pay to Pilot Life the amount of such excess upon receipt of a statement of the amount of such excess.

5. If this agreement is terminated as to new insurance, Pilot Life shall nevertheless be liable to [Taxpayer] for payment of monthly reinsurance premiums until all premiums on policies reinsured with [Taxpayer] prior to the termination have been earned, and [Taxpayer] shall nevertheless be liable to Pilot Life for payment of all claims arising out of policies reinsured with [Taxpayer] prior to the termination. After all reinsurance premiums have been paid, [Taxpayer] shall pay Pilot Life the amount of any claims on such reinsured policies, which claims were paid by Pilot Life and not deducted from reinsurance premiums, upon receipt of a statement of the amount of any such claims.

### Article IV.

1. [Taxpayer] shall be liable to Pilot Life for the benefits covered by reinsurance hereunder to the same extent as Pilot Life is liable to the persons insured for such benefits and all reinsurance shall be subject to the terms and conditions of the policy under which Pilot Life is liable.

2. Whenever a claim is made under a policy that Pilot Life reinsured under this agreement, it shall be considered by [Taxpayer] to be a claim for the full amount of reinsurance on such policy and [Taxpayer] shall abide by the settlement made by Pilot Life and shall pay the full amount of reinsurance.

> 3. Any suit or claim may be tested or compromised on the part of Pilot Life and in case of reduction of the claim made upon Pilot Life, the claim made upon [Taxpayer] shall be reduced accordingly. Any special expense incurred by Pilot Life in defending or investigating any claim shall be borne by [Taxpayer].

**19.** Plaintiff's disability reinsurance treaties with the ceding companies fell into the category of "reinsurance ceded"; *i.e.*, they were solely contracts of insurance between two insurance companies (the "ceding company" and the "reinsurer"), and did not create any contractual obligation running from the reinsurer (plaintiff) to the policyholders of the ceding companies. Such reinsurance did not relieve the ceding companies of contractual liabilities to their policyholders, e.g., the obligation to pay benefits and to refund unearned premiums in the event of cancellation or other termination of a policy before the expiration of its full term. Consequently, the mere fact that the ceding companies obtained reinsurance from plaintiff under these treaties did not affect their responsibility, under state law or under actuarial principles, to set up an unearned premium reserve to reflect the unearned premiums actually held by those companies or policies covered by reinsurance treaties with plaintiff. Ceding companies, however, may obtain a credit on their annual statement forms for unearned premium reserves actually transferred to a reinsurer since, as explained by plaintiff's expert, the liability for an unearned premium reserve "depends on whether you've got the money or not * * *"

**20.** An unearned premium reserve measures an insurance company's reserve requirements by looking to premiums already paid by policyholders and then determining the portion of such premiums that represent payment for insurance to be provided after the statement date. Plaintiff was not required to establish an unearned premium reserve with respect to its reinsurance of the ceding companies because, as of each statement date, no portion of the reinsurance premiums received and held by plaintiff represented payment for insurance to be provided after the statement date; *i.e.*, all such reinsurance premiums were fully earned.

**21.** Life insurance reserves may be measured prospectively as the difference between the present value of future claims expected to be paid and the present value of premiums to be received. Even if this prospective test had been applied to plaintiff's disability reinsurance treaties with the ceding companies, under any reasonable assumption as to future claims, the present value of reinsurance premiums to be received under such treaties exceeded the present value of probable claims. Thus, measured either retrospectively or prospectively, plaintiff did not have any reserve obligation under its treaties with the ceding companies.

22. Plaintiff had no contingent obligation to refund reinsurance premiums received from the ceding companies since it received such premiums only after they had been fully earned. Nor did plaintiff have any obligation to refund premiums paid by policyholders of the ceding companies in the event of cancellation or other premature termination of policies issued by the ceding companies. Consequently, there was no need for plaintiff to establish an unearned premium reserve for the purpose of maintaining a fund available for the refund of premiums.

23. Plaintiff also had a reinsurance treaty in force during the years in issue with Insurance City, which treaty covered both death and disability risks under credit life insurance policies issued by Insurance City to Aetna and its loan customers in the State of Rhode Island. All of the credit life insurance policies issued by Insurance City to Aetna and its loan customers (including those with disability benefits) provided for the payment of single premiums at the inception of the policy term on both life and accident and health coverages. Under its reinsurance treaty with Insurance City, plaintiff was entitled to receive the full disability premium collected by Insurance City for the entire policy term on policies covered under the treaty, less 10 percent of such premiums retained by Insurance City, in the month following receipt by Insurance City. Such reinsurance premiums were paid for reinsurance for the entire term of policies issued by Insurance City to Aetna and its loan customers during that month, and not merely for reinsurance actually provided by plaintiff during such month. Therefore, plaintiff maintained unearned premium reserves with respect to that portion of premiums received from Insurance City

which represented payment for reinsurance to be provided in the future.

**24.** The insurance business is regulated by the states. For example, the state insurance departments supervise policy forms, agency relationships, investments, accounting practices, reserves, and the general financial responsibility of insurance companies. State law and/or regulations direct insurance companies to set up reserves that are designed to preserve the solvency of those companies for the protection of policyholders.

**25.** For each of the years 1962, 1963, 1964, and 1965 plaintiff filed an annual statement with the Missouri Division of Insurance on the form prescribed by the National Association of Insurance Commissioners for life and accident and health companies. The annual statement is a record of the income and disbursements of an insurance company during the year on an accrual basis, as well as a balance sheet which reflects the solvency of the reporting insurance company at the end of the accounting period. The calendar year is the prescribed accounting period of all life insurance companies, including plaintiff.

**26.** Plaintiff's annual statements for the years 1962, 1963, 1964, and 1965 did not reflect any unearned premium reserves with respect to policies issued by Old Republic, Pilot, and National Fidelity, or with respect to plaintiff's reinsurance treaties with those companies. The only unearned premium reserves reflected on plaintiff's annual statements for the above years were unearned premium reserves relating to plaintiff's reinsurance treaty with Insurance City.

**27.** State insurance authorities monitor the adequacy of the reserves held by insurance companies within their jurisdictions by reviewing the annual statements submitted by those companies and by conducting a comprehensive audit at least once every three or four years. The examination includes a verification and evaluation of assets, the establishment of liabilities, and a general review of other records and procedures including the contracts and policies in force at the valuation date. If an insurance company did not properly report its liabilities as of the valuation date under examination, the examiners would recompute such liabilities in accordance with actuarial standards and governing state law and regulations.

**28.** Plaintiff was audited by the Missouri Division of Insurance in 1965 for the period from September 30, 1961, through December 31, 1964. Plaintiff was also audited in 1969 with respect to the period from January 1, 1965, through December 31, 1968, by the Missouri Division of Insurance with participation by examiners from the States of Maryland, Wyoming, and California. There was attached to the report of examination for the period September 30, 1961, through December 31, 1964, a statement from the consulting actuaries of plaintiff as follows:

> As Consulting Actuaries who aided in the preparation of the December 31, 1964 Financial Statement of American Universal Life Insurance Company, [now ITT Hamilton] we affirm that we determined the policy reserves listed below, and that the amounts thereof were computed in accordance with the terms of the outstanding policies and the Insurance Code of the State of Missouri, and that, based upon the records of the Company furnished to us, they are a true statement of the reserve liabilities of the Company as of December 31, 1964.
>
> 1. Aggregate Reserve for Life Policies___$806, 698. 00
> 2. Aggregate Reserve for A. & H. Policies_ 59, 673. 48

**29.** The Missouri Division of Insurance did not require plaintiff to establish unearned premium reserves with respect to premiums received by the ceding companies for disability benefits provided by those companies under policies issued to Aetna and its loan customers or with respect to reinsurance premiums received by plaintiff under its disability reinsurance treaties with such companies. According to plaintiff's expert witness, no state regulatory authority would impose an unearned premium reserve requirement on an insurance company where, as under plaintiff's disability reinsurance treaties with the ceding companies, such company did not receive premiums for insurance to be provided in the future.

**30.** The premium charge for a life insurance contract is computed so as to cover all the contingencies the insurance company is likely to meet, and these contingencies are generally grouped into three elements, namely, mortality, interest, and "loading" (*i.e.*, profit and expenses). Mortality refers to that part of the premium which provides for the occurrence of the risk insured against while the second element takes into account the assumed interest to be earned by the company. The third element primarily covers profit and the cost incident to management of the company, such as salaries, rents, commissions, taxes, and other costs of doing business. In arriving at a premium charge, the first and second step is the computation of what is called a "net premium" which takes into account only the mortality and interest elements. To the net premium is then added an amount called "loading" which is calculated to provide for profit and expenses. The resulting premium, called the "gross premium," is the premium charged to the policyholder.

**31.** The premium charge for accident and health insurance coverage is computed similarly to a life insurance premium, except that the mortality element of a life insurance premium is replaced by the "morbidity" element of the accident and health premium (*i.e.*, that part of the premium which provides for the occurrence of the *risk* of the insured becoming disabled because of accident or sickness).

**32.** Unearned premium reserves on casualty (including accident and health) insurance have traditionally been computed on an unearned *gross* premium basis; *i.e.*, the reserve is calculated as a portion of the entire premium received from the policyholder, including the portion charged to cover expenses and profits ("loading"). The computation of unearned premium reserves on an unearned gross premium basis stems from the historic practice of maintaining unearned premium reserves equal to the aggregate amount of premiums that would have to be refunded if all outstanding policies were canceled. However, the cost of carrying the insurance risk on an accident and health policy is the unexpired portion of the *net* premium charged to the policyholder. That part of the unearned premium reserve which represents the unexpired portion of the "loading" charge is not a true insurance reserve at all, but rather a solvency reserve or reserve for future expenses which in effect requires the reserving company to segregate part of its surplus until the policy has expired.

Life insurance reserves, in contrast to unearned gross premium reserves, are "risk only" reserves and do not include any portion of the loading charge made to the policyholder.

33. The unearned premium reserves of the ceding companies attributed to plaintiff were calculated on an unearned *gross* premium basis. As stipulated by the parties, the following "tabular morbidity reserves" represent the total "net premium" (*i.e.*, morbidity) element in the unearned gross premium reserves held by the ceding companies (including Old Republic) with respect to disability benefits included in credit life insurance policies issued by the ceding companies to Aetna and its loan customers:

| *Date* | *Total Tabular Morbidity Reserves* |
|---|---|
| December 31, 1962 | $434, 213 |
| December 31, 1963 | 503, 279 |
| December 31, 1964 | 559, 401 |
| December 31, 1965 | 652, 489 |

However, in view of defendant's concession that no unearned premiums (either net or gross) may be attributed to plaintiff from Old Republic (see finding 15, *supra*) the "net premiums" or "tabular morbidity reserves" in this paragraph have been restated by plaintiff's actuary so as to remove "net premiums" held by Old Republic. Mr. E. Dean Forbes, A.S.A., the actuary who computed the original tabular morbidity reserves appearing in paragraph 57 of the Stipulation of Facts has made this recomputation, removing net premiums held by Old Republic, and leaving only net premiums held by Pilot, National Fidelity, and plaintiff (under its Insurance City treaty).

In accordance with said recomputation, it is found that the following "Tabular Morbidity Reserves" represent the total "net premium" (*i.e.*, morbidity) element in the unearned gross premium reserves reflected on the annual statements of Pilot, National Fidelity, and plaintiff (under the Insurance City Reinsurance Treaty) on December 31, 1962, 1963, 1964, and 1965, respectively, with respect to credit accident and health insurance issued to loan customers of Aetna and its subsidiaries:

| *Date* | *Total Tabular Morbidity Reserves* |
|---|---|
| December 31, 1962 | $378, 238 |
| December 31, 1963 | 438, 390 |
| December 31, 1964 | 494, 819 |
| December 31, 1965 | 575, 216 |

The above "Tabular Morbidity Reserves" were computed on the basis of the 1964 Commissioners' Disability Table, a recognized morbidity table approved by the National Association of Insurance Commissioners.

**34.** Plaintiff qualifies as a "life insurance company" within the meaning of Section 801 of the Code for the years 1963 and 1965, even if unearned premium reserves of the ceding companies on disability benefits included in credit life insurance policies issued to Aetna and its loan customers are added to plaintiff's "total reserves" for those years, if the attributed reserves are calculated on a *net* basis. Plaintiff also qualifies as a life insurance company for the year 1964 if attributed reserves are calculated on a *net* basis assuming, however, that plaintiff is entitled to included unpaid losses on credit life insurance in both the numerator and denominator of the life insurance company qualification formula in that year.

Plaintiff's qualification ratio for each of the years in issue, based on a "net premium" attribution, is as follows:

*Plaintiff's Qualification Ratios Assuming Attribution of Net Premiums from Pilot and National Fidelity*

| | *Jan. 1, 1963* | *Dec. 31, 1963* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | $556, 923 | $733, 027 | $644, 975 |
| Total Reserves | 1, 036, 028 | 1, 302, 649 | 1, 169, 338 |
| Qualification Ratio (1÷2) | | | 55. 1% |

| | *Jan. 1, 1964* | *Dec. 31, 1964* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | 733, 027 | 806, 698 | 769, 863 |
| Total Reserves | 1, 302, 649 | 1, 873, 862 | 1, 588, 255 |
| Qualification Ratio (1÷2) | | | 48. 4% |

| | *Jan. 1, 1965* | *Dec. 31, 1965* | *Mean* |
|---|---|---|---|
| Life Insurance Reserves | 806, 698 | 1, 626, 902 | 1, 216, 800 |
| Total Reserves | 1, 873, 862 | 2, 305, 514 | 2, 089, 688 |
| Qualification Ratio (1÷2) | | | 58. 2% |

**35.** Those credit life insurance policies issued by the ceding companies to Aetna and its loan customers which included disability benefits are sometimes referred to in the insurance industry as life insurance contracts combined with accident and health insurance. They are conceptually identical to combined life, health and accident insurance contracts issued by insurance companies since the early part of this century, which provide payment of the face amount of policies in the event of death, or, if the insured becomes disabled, of installments of the face amount over a period of years.

**36.** The terms "cancellable" and "noncancellable" have definite and specific meanings in the insurance industry. The National Association of Insurance Commissioners has defined the term "noncancellable" as follows (NAIC, Report to the National Association of Insurance Commissioners Subcommittee on Definition of Non-Cancellable Insurance and Guaranteed Renewable Insurance 156 (1960):

> The terms "noncancellable" or "noncancellable and guaranteed renewable" may be used only in a policy which the insured has the right to continue in force by the timely payment of premiums set forth in the policy (1) until at least age 50, or (2) in the case of a policy issued after the age 44, for at least 5 years from its date of issue, during which period the insurer has no right to make unilaterally any change in any provision of the policy while the policy is in force.

Some accident and health policies are written for the life of the insured at a guaranteed annual premium. A reserve in addition to the unearned premium reserve must be maintained on such policies as a consequence of charging a premium for a benefit that costs increasingly more to provide as the insured grows older. This additional reserve is accumulated from premium payments and interest earnings that will not be needed to pay claims arising during the current policy year of the contract. The reserve is computed on the basis of recognized morbidity tables at an assumed rate of interest. An additional reserve is also required where the policy is written for some term which is shorter than the insured's life where the premium charged provides a benefit that costs increasingly more to provide as the insured grows older. Neither Old Republic, Pilot, nor National Fidelity maintained an additional reserve in addition to the unearned premium reserve with respect to credit accident and health insurance covering debtors of Aetna and its subsidiaries.

Although there is no analogy in life insurance to the unearned gross premium reserve required in casualty insurance, a life insurance reserve may be roughly compared with the unearned *net* premium element in the unearned premium reserve because both are computed on the basis of the actuarial cost of carrying the risk.

### *Plaintiff's Group Annuity Policy No. 101*

**37.** On December 22, 1965, plaintiff issued Group Annuity Contract No. 101 to the St. Louis Union Trust Company as Trustee of Pension Fund No. 6 of the International Telephone Retirement Plan for Salaried Employees, which contract has remained outstanding and in effect to the present time. On or about December 22, 1965, plaintiff received securities valued at $5,929,057.24 from the St. Louis Union Trust Company for the purchase of single premium annuities for certain retired individuals covered by the International Telephone Retirement Plan for Salaried Employees which obligated plaintiff to pay annuities to such retired individuals (and their spouses, in some cases) under the terms of Group Annuity Contract No. 101. Prior to this transaction, no group annuity or individual annuity contracts had been purchased by IT&T, the St. Louis Union Trust Company, or any Trustee of any pension fund existing under the International Telephone Retirement Plan for Salaried Employees from any insurance company or other person on the lives of the individuals covered under Group Annuity Contract No. 101.

**38.** Plaintiff maintained a reserve of $6,072,004 on December 31, 1965, with respect to its liabilities under Group Annuity Contract No. 101 on that date. Such reserve was computed on the basis of a recognized mortality table (1951 G.A.) and an assumed rate of interest (3½%), and was set aside to mature or liquidate future unaccrued claims arising under Group Annuity Contract No. 101.

### *Deficiency Reserves*

**39.** The accepted definition of a deficiency reserve in the insurance industry is the amount by which the present value of the future premiums required (by statute) for a life insurance or annuity contract exceeds the present value of the future premiums and consideration actually charged for such contract.

**40.** By definition, there can be no deficiency reserve requirement with respect to a life insurance or annuity contract once all premiums called for under such contract have been paid. Thus, there can never be a deficiency reserve required with respect to a single premium life or annuity policy under which the entire premium is payable at the inception of the policy. All of the life and annuity policies reinsured or issued by plaintiff during the years in issue were single premium policies of this type. On an ordinary whole life insurance policy, the deficiency reserve required at the inception of the policy, if any, gradually diminishes as premiums are received by the company. Defendant now concedes this issue.

### *History of the Controversy*

**41.** For each of the years 1963, 1964, and 1965, plaintiff timely filed with the District Director of Internal Revenue at St. Louis, Missouri, a Federal income tax return on Treasury Form 1120L, U.S. Life Insurance Company tax return, and computed its taxable income and tax as a life insurance company according to Section 802 of the Code. The tax shown to be due on the returns filed for those years, as reported in the table below, was paid in full.

| *Year* | *Tax Shown to be Due on Plaintiff's Return* |
|---|---|
| 1963 | $479, 356. 02 |
| 1964 | 377, 217. 70 |
| 1965 | 467, 266. 14 |

**42.** On August 18, 1967, plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, claims for refund of income taxes previously paid in respect of the years 1963, 1964, and 1965 (hereinafter referred to as the 1967 claims) in the following amounts:

| *Year* | *Amount Claimed* | |
|---|---|---|
| 1963 | $156, 148. 50 | (or $143,737.56 in the alternative) |
| 1964 | 140, 482. 78 | |
| 1965 | 47, 252. 76 | |

Neither the Secretary of the Treasury nor his delegate having theretofore rendered a decision on the 1967 claims, plaintiff, on April 4, 1968, filed suit for a refund of such income taxes in this court.

**43.** On October 24, 1968, after plaintiff had filed a petition claiming a refund of income taxes paid in respect of the years 1963, 1964, and 1965 in this court, and prior to a hearing of plaintiff's claims, the Commissioner of Internal Revenue determined deficiencies in plaintiff's income tax for the years 1963, 1964, and 1965 in the following amounts:

| *Year* | *Deficiency* |
|---|---|
| 1963 | $337, 376. 70 |
| 1964 | 362, 986. 20 |
| 1965 | 265, 412. 05 |

The asserted deficiencies were based upon a determination that plaintiff did not qualify as a life insurance company during the years 1963, 1964, and 1965 under Section 801 (a) of the Code, but rather was taxable as an insurance company other than a life or mutual insurance company in those years.

44. Plaintiff did not file a petition with the Tax Court for a redetermination of the asserted deficiencies within the time allowed by Section 6213 (a) of the Code, or at any time thereafter. On February 14, 1969, the Commissioner of Internal Revenue assessed the amount of the asserted deficiencies in plaintiff's income tax for the years 1963, 1964, and 1965, together with interest on such deficiencies, and demanded payment thereof. Plaintiff contests the validity of this assessment. On March 5, 1969, the following amounts were paid to the District Director of Internal Revenue at St. Louis, Missouri, under protest, in respect of the deficiencies in plaintiff's income taxes assessed for the years 1963, 1964, and 1965, and interest thereon:

| *Year* | *Deficiency* | *Interest* | *Total* |
|---|---|---|---|
| 1963 | $337, 376. 70 | $99, 747. 96 | $437, 124. 66 |
| 1964 | 362, 986. 20 | 85, 540. 43 | 448, 526. 63 |
| 1965 | 265, 412. 05 | 46, 621. 63 | 312, 033. 26 |

45. On April 21, 1969, plaintiff filed with the District Director of Internal Revenue at St. Louis, Missouri, claims for refund of the amounts assessed by the Commissioner of Internal Revenue on February 14, 1969, and paid by plaintiff on March 5, 1969, as additional income taxes, and interest thereon, for the years 1963, 1964, and 1965 (hereafter referred to as the 1969 claims). Plaintiff received a formal notice of disallowance of its 1969 claims from said District Director on December 3, 1969, and filed its First Amended Petition

with this court on March 30, 1970, seeking recovery of income taxes with respect to both its 1969 and 1967 claims.

**46.** On May 8, 1969, defendant filed a motion with this court for leave to file an amended answer to plaintiff's petition. Defendant's motion was allowed and an amended answer was filed on July 8, 1969, which amended answer included a counterclaim alleging that the Commissioner of Internal Revenue had assessed additional income taxes and interest for the years 1963, 1964, and 1965 and demanded payment thereof and that such assessment had not been paid. Plaintiff filed a reply to defendant's counterclaim on August 12, 1969, alleging, *inter alia*, full payment of such additional taxes and interest.

**47.** In its Answer to plaintiff's First Amended Petition, defendant stated that "since the Plaintiff has paid the taxes for which the counterclaim was filed and amended its petition to include a claim for refund for these taxes, a counterclaim by the defendant is no longer necessary, nor required by law." Defendant's Answer to First Amended Petition, Count I ¶ 13(d), Count II, ¶ 11(d), Count III, ¶ 13(d), Count IV, ¶ 13(d).

### *Ultimate Finding of Fact*

**48.** During each of the years 1963, 1964, and 1965, plaintiff was a life insurance company engaged in the business of issuing or reinsuring life insurance and annuity contracts (issued either separately or combined with accident and health insurance) and its life insurance reserves plus unearned premiums and unpaid losses on non-cancellable life, health or accident policies not included in life insurance reserves comprised more than 50 percent of its total reserves during each of those years within the meaning of Section 801 of the Internal Revenue Code of 1954.

## CONCLUSION OF LAW

Upon the foregoing findings of fact which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is entitled to recover, and judgment is entered to that effect, with the determination of the amount of recovery to be made in further proceedings under Rule 131(c).

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524 F. 2d 1167

# CONSUMER LIFE INSURANCE COMPANY v. THE UNITED STATES

[No. 463-70. Decided October 22, 1975]

ON THE PROOFS

**Taxes; income tax; qualification as life insurance company; reserve ratio test; Arizona and Georgia laws.**—Plaintiff, incorporated as an insurance company under an Arizona charter in July 1957, is a wholly-owned subsidiary of a Georgia company (S) which operated a consumer finance business. Because Georgia law prohibited (S), as a loan company, from acting as an insurance underwriter with respect to purchases by its customer-borrowers of term life and accident and health insurance at the time the latter obtained the loans, until 1957 (S) acted as a commission sales agent for life and accident and health insurance underwritten by carrier (A) which was qualified to conduct an insurance business in Georgia. (S), having determined that it could obtain greater profits if it participated as an underwriter rather than a sales agent, formed plaintiff with a modest initial balance of invested capital and paid-in surplus. These resources, however, were insufficient to permit plaintiff to qualify as a direct insurer under Georgia law, but it could use its Arizona charter authority to operate as a reinsurer of Georgia and North Carolina coverages written by (A). Concurrently, (A) entered into Treaty I with plaintiff under which all life and accident and health policies issued by (A) to debtors of plaintiff's affiliates were to be fully reinsured with plaintiff which assumed the entire insurance risk represented by each policy involved. As compensation for its reinsurance function, plaintiff received, in monthly remittances, 87½% (later increased to 90½%) of all premiums collected by (A). As to the life policies, at the end of each month (A) was to pay plaintiff its entire share of all life premiums collected during that month. As to accident and health insurance, (A) was to pay plaintiff only the portion of its total share of premium receipts during that month that was ratably allocable to that month's coverage, the agreement being to pay over the remainder monthly on a pro rata basis spread over the balance of the coverage period. Thus, as to accident and health policies, plaintiff never actually held any premium income attributable to a future period of coverage and risk exposure. As required by state law, plaintiff filed annual reports with the insurance authorities of Arizona and Georgia. For life coverages it declared as premium income its entire percentage share of premiums paid by policyholders during the year, showing the full tabular reserve for such policies. For the accident and health policies reinsured under Treaty I, plaintiff reported no unearned premium reserves; as to those coverages, (A) reported unearned premium reserves. Georgia and Arizona accepted the accident and health reinsurance reports without challenge. Plaintiff, having accumulated enough earnings via Treaty I to enable it to qualify as a direct insurer under Georgia and North Carolina law, in March 1962 entered into Treaty II with (A) which applied only to accident and health insurance. Under that treaty plaintiff, as the issuing or ceding company, reinsured 80% of all future accident and health policies with (A), paid over to (A) on a quarterly basis all of the premiums collected from policyholders, (A) returned 50% of such amounts to plaintiff as commissions, and (A) returned quarterly to plaintiff a refund in the amount of the total premium dollars ratably allocable to the expired portion of the term of policies for which such premiums had been collected, less, *inter alia*, 3% of the earned premium dollars. (A) was responsible for risks, and any losses exceeding the 3% amount were borne by (A). For 1962 onward, plaintiff reported to the state authorities no reserves relative to the Treaty II accident and health policies. Arizona insurance authorities conducted examinations of plaintiff in 1959 and 1963, and certain southern states including Georgia, North Carolina and Arizona conducted examinations of (A's) reinsurance activities, the reinsurance treaties being examined in detail in the course of these examinations. During 1958–1964 plaintiff computed its federal income taxes and filed its returns as a life insurance company within the meaning of Sec. 801 of the 1954 Internal Revenue Code. The Commissioner of Internal Revenue determined that plaintiff did not qualify as a life insurance company and assessed deficiencies (except for 1961), plaintiff paid the assessments and upon disallowance of its claims for refund brought this suit. It is *held* (1), following the rationale of *Penn Security Life Ins. Co.* v. *United States*, decided concurrently, *ante* at 594, that the unearned accident and health insurance premiums or the reserves based on those premiums are not attributable to plaintiff in determining its qualification as a life insurance company under Sec. 801; (2) that Arizona Revised Statutes Annotated Sec. 20–501(5) and (9), Sec. 20–505 and Sec. 20–501(8) do not apply to plaintiff's circumstances, and accordingly state law did not require plaintiff to establish reserves for the premiums involved here. Plaintiff is entitled to recover, the amount of recovery to be determined in further proceedings.

**Taxes; income tax; life insurance companies; status of company as insurance company; reserve ratio test.**

[1] Under Sec. 801 of the 1954 Internal Revenue Code, life insurance company status is made to depend solely on the character and composition of an insurance company's reserves, and life in-

surance tax treatment is merited if the company's life reserves amount to half or more of its total insurance reserves, the total reserves consisting of life reserves, reserves for unearned premiums and for certain unpaid losses, and all other reserves required by law.

Internal Revenue 🔑 826

**Taxes; income tax; life insurance companies; status of company as insurance company; reserve ratio test.**

[2] For purposes of measuring plaintiff's reserves pursuant to requirements for qualification as a life insurance company under Sec. 801 of the 1954 Code, where plaintiff under its reinsurance Treaties with unrelated company (A) only received earned health and accident insurance premiums and where reserves for health and accident insurance covered by said reinsurance treaties were neither held by plaintiff nor reported or claimed on its annual reports to state insurance regulatory bodies and the reports were accepted by said bodies, unless establishment of such reserves is required by such bodies or by state law, unearned accident and health insurance premiums or reserves based on those unearned premiums held by (A) are not attributable to plaintiff as an element affecting its reserve ratio requirement.

Internal Revenue 🔑 826

**Taxes; income tax; life insurance companies; status of company as insurance company; Arizona law; assets defined.**

[3] An insurer's assets as defined in Arizona Revised Statutes Annotated Sec. 20-501 (5) and (9) are those items in the possession of the insurer or assuming insurer or to which the insurer or assuming insurer has an enforceable claim. Thus, since an unearned health and accident premium is not included in the present taxpayer's assets there can be no unearned premium reserve charged against that item.

Internal Revenue 🔑 531

**Taxes; income tax; life insurance companies; reinsurance of risks of accident and health insurance policies; Arizona and Georgia laws.**

[4] Where plaintiff reinsured the accident and health insurance it issued with unrelated company (A) pursuant to a treaty providing that (A) only kept 3% of the premiums, since (A) sustained any losses exceeding the 3%, plaintiff can be said to have reinsured its risk and under Code of Georgia Annotated and Arizona Revised Statutes Annotated the treaty qualified as reinsurance and plaintiff was entitled to take credit for the reserves.

Internal Revenue 🔑 531

**Statutes; construction and operation; administrative interpretation.**

[5] Generally, in the absence of a court decision, the interpretation placed upon a doubtful or ambiguous statute by the regulatory body charged with enforcement thereof is compelling authority

**and will not be overthrown except for cogent reasons. This rule applies to state administrative interpretations or actions under state statutes.**

**Statutes ⚿ 219(2)**

*E. Michael Masinter*, attorney of record, for plaintiff. *James H. Landon* and *Hansell, Post, Brandon & Dorsey*, of counsel.

*Herbert Grossman*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, of counsel.

Before Cowen, *Chief Judge*, Laramore, *Senior Judge*, Skelton, Nichols, Kashiwa, Kunzig, and Bennet, *Judges*.

Kashiwa, *Judge*, delivered the opinion of the court:

This is a single issue tax refund suit that arises out of a small loan company's entry into the insurance business through a wholly owned subsidiary that is formed especially for that purpose. The question is whether that subsidiary, the plaintiff in this proceeding, qualified for the tax treatment accorded a "life insurance company" by §§ 801 et seq. of the Internal Revenue Code of 1954. We hold for the plaintiff.

This case is before this court on a review of a recommended decision of Trial Judge George Willi. The court disagrees with the conclusions. A similar case, *Penn Security Life Insurance Co.* v. *United States*, *ante* at 594, is decided contemporaneously herewith. Issues decided therein and applicable herein are disposed of by reference to said decision; but as hereafter shown, plaintiff in this case has raised new questions based on state regulatory statutes. This decision discusses these state statutes which defendant claims are relevant.

The facts are fully detailed in the findings of fact accompanying this opinion and will be repeated herein only to the extent necessary to an understanding of the result reached.

In 1957 Southern Discount Company (Southern), a Georgia corporation, was operating a well established and successful consumer finance business. Its customer-borrowers typically purchased term life and accident and health (A & H) insurance at the time that they obtained their loans. The premium charge for the entire coverage involved was thereupon paid in full. The customers bought this protection, coextensive in both time and amount with the curtailment requirements of their borrowings, to provide a means of automatically servicing their debts to Southern in case of death or disability prior to full repayment. Georgia law prohibited Southern, as a loan company, from acting as an insurance underwriter with respect to such coverages. It was not forbidden, however, from functioning as a sales agent for insurance underwritten by a carrier duly qualified to conduct an insurance business in Georgia. American Bankers Life Insurance Company (American Bankers), a Florida corporation, was such a carrier.

Until 1957 Southern acted as a commission sales agent for American Bankers in respect to life and A & H insurance issued by the latter to Southern's borrowers. Under this arrangement, Southern received the maximum commission rate allowed by law; amounting to approximately 50 percent of the policyholder premiums. Despite the attractiveness of that return, for which it apparently had to do little more than place American Bankers' policies with its own borrowers, Southern concluded that it could reap even greater profits from this source if it could participate as an underwriter rather than just a sales agent. It was that determination that prompted Southern to form the plaintiff as a wholly owned subsidiary.

Southern surveyed state law to locate the jurisdiction that had the most modest capitalization requirements for a licensed insurer and found that it was Arizona. Plaintiff was organized July 1, 1957 as an insurance company under an Arizona charter with an initial balance of invested capital and paid-in surplus of only $38,000. These resources were not sufficient to permit it to qualify as a direct insurer under Georgia law. It could, however, use its Arizona charter authority to operate as a reinsurer of Georgia and North Carolina coverages written by American Bankers—a duly authorized insurer in both of those states. American Bankers was willing to enter into a reinsurance treaty arrangement with plaintiff, under which it surrendered substantially all underwriting profit in return for a relatively minimal fixed fee, because it knew that if it refused, Southern would have no difficulty in replacing it with another qualified carrier. Thus, its alternative was outright exclusion from the insurance business generated by Southern's borrowers. Thereupon, on June 28, 1957, American Bankers entered into the first of two consecutive insurance treaties (Treaty I and Treaty II, respectively) with the plaintiff.

Under Treaty I, all life and A & H policies issued by American Bankers to debtors of plaintiff's affiliates (including the parent, Southern) on and after July 1, 1957 were to be fully reinsured with plaintiff which, as it freely concedes, thereby assumed the entire insurance risk represented by each of the policies involved; A & H as well as life. As compensation for its reinsurance function, plaintiff was to receive 87½ percent (later increased to 90½ percent) of all premiums collected by American Bankers from the policyholders. The timing of these payments by American Bankers to plaintiff differed, however, as between life and A & H, although the agreement required monthly remittances in each instance. As already noted, American Bankers collected all premiums in full at the inception of coverage. The Treaty stipulated that as to life policies, American Bankers was, at the end of each month, to pay plaintiff its entire share of all life premiums collected from policyholders during that month. As to A & H, however, American Bankers was to pay plaintiff only the portion of its total share of premium receipts during that month that was ratably allocable to that month's coverage; the agreement being to pay over the remainder monthly on a pro rata basis spread over the balance of the coverage period. Thus, in respect to A & H, plaintiff never actually held any premium dollars attributable to a future period of coverage and risk exposure.

Finally, Treaty I provided for termination by either party upon thirty days written notice to the other. Termination was to be wholly prospective, the relevant clause specifying: "Upon termination by either party, this agreement shall continue to apply to all policies reinsured hereunder before such termination becomes effective."

As required by state law, plaintiff filed annual reports of its activities under Treaty I with the insurance regulatory authorities in Arizona and Georgia. On those reports it characterized its life and A & H dealings differently. It did so by reporting both premium income and related reserves solely on the basis of actual dollar receipts for the year involved. This meant that for the life coverages it declared as premium income its entire percentage share of the premiums paid by policyholders during that year. Consonantly, it reported the full tabular reserve for all of such policies. As to A & H, however, it limited reported premium income to the annual aggregate of the incremental payments that had been received monthly from American Bankers. Moreover, it showed nothing on the asset side of the report representing the premiums on existing A & H policies that it was entitled under the Treaty to receive in the future. With premium income and asset balances thus restricted, plaintiff reported no reserves whatever in respect to the A & H coverages that it reinsured under Treaty I. As to those coverages, American Bankers included on its own annual reports an unearned premium reserve based on the amount of A & H premiums collected from policy holders but not yet paid over to the plaintiff. Neither the Georgia nor the Arizona regulatory authorities ever challenged or disapproved the method by which plaintiff reported its A & H reinsurance activities under Treaty I.

By 1962 plaintiff had accumulated enough earnings from operations under Treaty I to enable it to qualify as a direct insurer under Georgia and North Carolina law. It thereupon applied for and received such authority from the State of Georgia. From then on plaintiff operated as the issuing company on all life and A & H policies sold to the loan customers of Southern and its affiliates. Treaty I, in which plaintiff's role was solely that of a reinsurer, was consequently no longer suited to its purposes. Accordingly, effective March 1, 1962, plaintiff and American Bankers entered into a new insurance treaty under which their roles were reversed; plaintiff functioning as the issuing or ceding carrier and American Bankers denominated the "reinsurer".

Treaty II applied only to A & H insurance; plaintiff having determined to underwrite all future life insurance by itself. The treaty provided that plaintiff, as the issuing or ceding company, would reinsure 80 percent of all future A & H policies with American Bankers. To that extent, plaintiff was to pay over to American Bankers on a quarterly basis all of the premiums collected from policyholders, American Bankers to return 50 percent of such amounts to the plaintiff as commissions. The Treaty contained a clause, entitled Experience Refunds, establishing a quarterly rebate due plaintiff in the amount of the total premium dollars ratably allocable to the expired portion of the term of policies for which such premiums had been collected, less the following deductions: (a) the amount of commissions paid plaintiff that was proportionate to the expired portion of the term of policies on which such commissions had been paid; (b) 3 percent of the earned premium dollars previously described; and (c) the sum of all claim payments made to plaintiff during the quarter by American Bankers as reinsurer. For all practical purposes, this clause served to fix American Bankers' stake in the undertaking at a flat 3 percent of the premium dollars that it initially received from the plaintiff. Only if loss experience under the reinsured coverages exceeded 47 percent of premiums would American Bankers' 3 percent return be encroached. Moreover, such a pattern of adverse experience would have had to persist for the ensuing twenty consecutive quarters before such an encroachment became permanent. Loss experience on A & H policies under Treaty I had ranged from 28 to 30 percent. Finally, there were no circumstances under which American Bankers' return under Treaty II could exceed the 3 percent allotted to it therein.

On its annual reports to the state regulatory authorities covering 1962 and subsequent years, plaintiff declared no reserves relative to that portion of the A & H policies covered by the reinsurance language of Treaty II. Again, no state regulatory authority took exception to this aspect of plaintiff's reports.

The insurance industry is regulated by the states. A particular insurance company must meet the various industry requirements of its home state, and must satisfy the requirements of all states in which it is qualified to act as an insurer. The state requirements include standards for investments, maintenance of reserves, and accounting practices. The state insurance departments supervise policy forms, agency relationships, and the general financial activities of the companies within their jurisdictions. This regulation is designed to preserve the solvency of the insurance companies for the protection of the policyholders. To implement their regulatory function, state insurance departments require companies to file annual reports. Because reports are required in all states in which a company is qualified to act as an insurer, a standard report form has been developed by the National Association of Insurance Commissioners, which is used in all fifty states. These reports disclose, among other things, the reserves being maintained by each company.

In addition to requiring annual reports, the various state insurance departments conduct regular triennial examinations of insurance companies. Where the volume of business warrants it as to a particular company, it is customary for representatives of several state insurance departments to work together on these examinations. The examinations are carried out at the offices of the company in question and may take as long as several months for large companies. Among the matters which are investigated in the course of such an examination are the reinsurance treaties to which a particular company is a party.

When a state insurance department is presented with a reinsurance agreement in existence between parties, its investigation will include a determination that each party has established adequate reserves according to its respective liabilities pursuant to the terms of the reinsurance agreement.

Plaintiff was the subject of triennial examinations in 1959 and 1963 by the insurance department of Arizona. American Bankers was the subject of triennial examinations in 1960 and 1963. Participants in the 1960 examination were from the insurance departments of Florida, North Carolina, Georgia, and Texas; and participants in the 1963 examination were from the insurance departments of Florida, Georgia, Arizona, and Arkansas. The reinsurance treaties between plaintiff and American Bankers were examined in detail in the course of the aforesaid examinations. The existence of reserves for accident and health insurance held by American Bankers on the policies covered by those treaties was clear to the examiners. Also the maintenance of the reserves by American Bankers under the treaties during Period I and Period II was approved in the course of the four examinations; no requirement or even suggestion was made in the examination reports that the reserves should be otherwise maintained.

For each of the years 1958 through 1964 plaintiff computed its federal income tax liabilities and filed its returns on the premise that it was taxable as a "life insurance company" within the meaning of that term as defined by Section 801 of the Internal Revenue Code of 1954. On audit, the Revenue Service determined that plaintiff did not qualify as a life insurance company entitled to the preferential tax treatment accorded such an entity and assessed deficiencies accordingly (except for 1961 in which additional liability was fully expunged by other adjustments not in dispute). Plaintiff paid the assessments and upon formal disallowance of its seasonably filed claims for refund, brought this action in which the sole question for decision is that concerning plaintiff's qualification as a life insurance company for federal tax purposes in the years 1958, 1959, 1960, 1962, 1963, and 1964.

As pertinent here, Section 801 defines a life insurance company as follows:

> SEC. 801 [as amended by Sec. 2, Life Insurance Company Income Tax Act of 1959, P.L. 86-69, 73 Stat. 112]. DEFINITION OF LIFE INSURANCE COMPANY.
>
> (a) *Life Insurance Company Defined.*—For purposes of this subtitle, the term "life insurance company" means an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, if—
>
> (1) its life insurance reserves (as defined in subsection (b)), plus
>
> (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, health, or accident policies not included in life insurance reserves,
>
> comprise more than 50 percent of its total reserves (as defined in subsection (c)).

* * * * *

> (c) *Total Reserves Defined.*—For purposes of subsection (a), the term "total reserves" means—
>
> (1) life insurance reserves,
>
> (2) unearned premiums, and unpaid losses (whether or not ascertained), not included in life insurance reserves, and
>
> (3) all other insurance reserves required by law.
>
> The term "total reserves" does not include deficiency reserves (within the meaning of subsection (b)(4)).

* * * * *

Life insurance company status, it is seen, is made to depend solely on the character and composition of an insurance company's reserves. An insurance company merits life insurance company tax treatment if its life reserves amount to half or more of its total insurance reserves. Section 801(c) expressly directs that total reserves, the denominator portion of the fractional test, shall include three separate categories: (1) life reserves; (2) reserves for unearned premiums and for certain unpaid losses (the latter element not being involved in this suit); and (3) all other reserves required by law.[1]

Sections 1.801-3(e) and 1.801-5(b) of the Treasury Regulations on Income Tax (1962), endorsed by both parties to the present controversy, define unearned premiums and reserves required by law, respectively, as follows:

> *Unearned premiums.* The term "unearned premiums" means those amounts which shall cover the cost of carrying the insurance risk for the period for which the premiums have been paid in advance. Such term includes all unearned premiums, whether or not required by law.

* * * * *

> *Reserves required by law defined.* For purposes of part I, subchapter L, chapter 1 of the Code, the term "reserves required by law" means reserves which are required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, and which are reported in the annual statement of the com-

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[1] The last-mentioned category has been traditionally and centrally implicated in the federal taxation of insurance companies. *See Brown* v. *Helvering*, 291 U.S. 193, 201 (1934), and cases cited therein.

> pany and accepted by state regulatory authorities as held for the fulfillment of the claims of policyholders or beneficiaries.

In this case there is no disagreement as to either the fact or the particular amount of plaintiff's life insurance reserves for each of the years in suit. Its qualification depends entirely on the question of its chargeability with reserves incident to the A & H policies to which it was a party under Treaties I and II; there being no dispute that reserves must be maintained by someone in respect to those policies. If those reserves are includable in plaintiff's total reserves, it concededly does not pass the 50 percent test of Section 801. If, as plaintiff says, they are chargeable to American Bankers rather than to itself, it does.

To dispel the notion that it was required to maintain A & H reserves of a type comprehended by Section 801, plaintiff relies on (1) the language of the two insurance treaties under which it operated with American Bankers; (2) the testimony of a well-traveled actuarial expert, Arthur Crooks Eddy; (3) the fact that the state insurance regulatory personnel tacitly approved plaintiff's annual report forms showing no A & H reserves; and (4) Trial Judge Fletcher's opinion in *Penn Security Life Ins. Co.* v. *United States* (Ct. Cl. No. 109–68, decided March 2, 1973).

Plaintiff's argument is simply that plaintiff was chargeable with no A & H unearned premium reserves because under both of the Treaties it received premium dollars only after the period of exposure to which those dollars related had expired. Accordingly, plaintiff says, since all the premiums that it received were, in point of time, already "earned" when it got them, there was no occasion for it to maintain a reserve for "unearned" premiums. Testifying as plaintiff's expert, Mr. Eddy repeatedly opined that this feature of the Treaties, governing custody of prepaid premium dollars, was dispositive of the participants' respective reserve obligations, *i.e.*, that since it was American Bankers that physically held all of the A & H premium dollars allocable to the unexpired portion of the terms of the underlying policies, it was American Bankers, not plaintiff, that was obligated to carry the reserves for those policies. In this regard, his testimony was the same as it apparently had been in *Penn Security*, *supra*. In the latter case, the relevant particulars of the factual situations involved were virtually identical to those presented by Treaty I.

Defendant's argument is that plaintiff's total reserves in the reserve ratio must include the unearned premium reserves on the accident and health policies because those reserves must be attributed to the company ultimately liable for the insurance risks. Alternatively, if the unearned premium reserves must be required by law to be recognized, they were so required here.

Issued contemporaneously with this opinion is the per curiam decision in *Penn Security Life Insurance Co.* v. *United States*, *ante* at 594. That case involves life insurance company qualification and the provisions of § 801 dealing with health and accident insurance. The situation is similar to this case with that taxpayer reinsuring risks written by three unrelated insurance companies under credit life and accident and health policies on the lives and health of debtors of taxpayer's parent which made consumer loans through subsidiaries operating finance offices. That opinion disposes of the issue under § 801(c)(2), unearned premiums, with the court concluding against attribution to plaintiff of the unearned premium reserves held by the ceding companies. We, therefore, consider the question settled. However, this leaves for determination here the § 801(c)(3) issue, insurance reserves required by law.

The defendant's major argument in this case is that the reserves were required by law because Arizona Revised Statutes Annotated § 20-501(5) and (9)[2] apply in that the premiums were assets of the plaintiff because they were "in the

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[2] § 20–501. *"Assets" defined*

"In any determination of the financial condition of an insurer, there shall be allowed as assets only such assets as are owned by the insurer and which consist of:

"1. Cash in the possession of the insurer, or in transit under its control, and including the true balance of any deposit in a solvent bank or trust company.

* * * * *

"5. Premiums in the course of collection, other than for life insurance, not more than three months past due, less commissions payable thereon. The forecourse of collection" and they were "withheld by a solvent ceding insurer under a reinsurance treaty." We interpret these sections to mean that they refer to amounts already due and unpaid. The definition of assets under § 20–501 refers to items in the possession of the taxpayer or to which the taxpayer has an enforceable claim. Without including the unearned premium in taxpayer's assets, there can be no unearned premium reserve charged against that item. The Arizona provisions do not apply to plaintiff's circumstances.

Turning to the liability side of the statute, defendant argues that § 20–505 [3] requires that plaintiff establish reserves on the accident and health policies. It would appear from

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going limitation shall not apply to premiums payable directly or indirectly by the United States or by any of its instrumentalities.

"6. Installment premiums other than life insurance premiums, in accordance with regulations prescribed by the director consistent with practice formulated or adopted by the national association of insurance commissioners.

"7. Notes and like written obligations not past due, taken for premiums other than life insurance premiums, on policies permitted to be issued on such basis, to the extent of the unearned premium reserves carried thereon.

"8. The full amount of reinsurance recoverable by a ceding insurer from a solvent reinsurer and which reinsurance is authorized under § 20–261.

"9. Amounts receivable by an assuming insurer representing funds withheld by a solvent ceding insurer under a reinsurance treaty.

"10. Deposits or equities recoverable from underwriting associations, syndicates and reinsurance funds, or from any suspended banking institution, to the extent deemed by the director available for the payment of losses and claims and at values to be determined by him.

"11. All assets, whether or not consistent with the provisions of this section, as may be allowed pursuant to the annual statement form approved by the national association of insurance commissioners for the kinds of insurance to be reported upon therein.

"12. Other assets, not inconsistent with the provisions of this section, deemed by the director to be available for the payment of losses and claims, at values to be determined by him."

* * * * *

[3] § 20–505. *Liabilities*

"In any determination of the financial condition of an insurer, capital stock and liabilities to be charged against its assets shall include:

* * * * *

"3. With reference to life and disability insurance and annuity contracts:

* * * * *

"(b) Reserves for disability benefits, for both active and disabled lives,

* * * * *

"(d) Any additional reserves which may be required by the director consistent with practice formulated or approved by the national association of insurance commissioners, on account of such insurance.

"4. With reference to insurance other than specified in paragraph 3 of this section, and other than title insurance, the amount of reserves equal to the unearned portions of the gross premiums charged on policies in force, computed in accordance with this article."

reading this statute that liabilities of an insurer "charged against its assets" implies that there were corresponding assets in the first place. Since there were not, this statute is inapplicable. Section 20–506A,[4] referring to disability insurance, provides that "every insurer shall maintain an unearned premium reserve on all policies in force." If there are two or more insurers on the same policy, they are not all meant to keep a reserve. This is how the state administrative practice operates. As long as someone has the reserve, this is sufficient.

Under Treaty II plaintiff reinsured with American Bankers. This was authorized under Code of Georgia Annotated § 56–413.[5] Section 56–906(2)[6] provides for a deduction of reinsurance from gross premiums before computing

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[4] § 20–506. *Unearned premium reserve*

"A. With reference to insurance against loss or damage to property, except as provided in § 20–507, and with reference to all general casualty insurance, disability insurance, except as provided in §§ 20–508 and 20–510, and surety insurance, every insurer shall maintain an unearned premium reserve on all policies in force."

[5] § 56–413. *Authorized reinsurance.*—"(1) An insurer shall reinsure its risks, or any part thereof, only in solvent insurers having surplus to policy holders or trusteed funds on deposit in the United States for the benefit of their policyholders not less in amount than the paid-in capital required under this Title of a domestic stock insurer authorized to transact like kinds of insurance.

"(2) An insurer shall so reinsure in such alien insurers only as either (a) are authorized to transact insurance in at least one state of the United States, or (b) have in the United States a duly authorized attorney-in-fact to accept service of legal process against the insurer as to any liability which might arise on account of such reinsurance, or (c) may be approved by the Commissioner. In the event reinsurance is placed which is not in compliance with the foregoing provisions, the ceding insurer shall not be allowed credit for such reinsurance either as an asset or deduction from liability, nor may it increase any amounts it is authorized to have at risk because of such reinsurance.

"(3) No credit shall be allowed, as an asset or as a deduction from liability, to any ceding insurer for reinsurance nor increase the amount it is authorized to have at risk unless the reinsurance is in insurers either authorized to do business in this State, or which have been approved by written order of the Department filed in its office and which order has not been subsequently disapproved; Provided, however, that such credit shall be allowed for reinsurance ceded to unauthorized alien assuming insurers, if such insurers have maintained in the United States for not less than 10 years immediately preceding such reinsurance a trust fund of not less than $50,000,000 available for the purpose of protecting policyholders in the United States. Nor shall such credit be allowed unless the reinsurance is payable by the assuming insurer on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer.

* * * * *

"(5) Notwithstanding the provisions of this Code, full credit shall be allowed a ceding insurer, as an asset or as a deduction from liability, for the unearned premium reserve. Arizona Revised Statutes Annotated § 20-261 [7] and § 20-506B [8] are similar. Defendant argues that Treaty II is a Surplus Aid contract in that since plaintiff did not reinsure its risks despite the formalities, the treaty did not qualify as authorized reinsurance and plaintiff could not take credit for the reserves. In answer to this, it can only be said that plaintiff did reinsure its risk. American Bankers was responsible for the risk and even though it only kept 3 percent of the premiums, in the event that

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all reinsurance which may be in effect or which may be hereafter effected under any contract or reinsurance in effect on the 31st day of December 1959, and any continuations or renewals of such contract of reinsurance. Provided, however, that no new insurance risk shall be ceded after two years from the effective date of this Title unless such reinsurance contract meets all the standards set forth in this Title."

[6] § 56-906

"(2) The Commissioner may require that such reserves shall be equal to the unearned portions of the gross premiums in force after deducting reinsurance in solvent insurers as computed on each respective risk from the policy's date of issue. If the Commissioner does not so require, the portions of the gross premium in force, less reinsurance in solvent insurers to be held as a premium reserve, shall be computed according to the following table:"

* * * * *

[7] § 20-261. *Authorized reinsurance*

"A. An insurer shall reinsure its risks, or any part thereof, only in solvent insurers having surplus to policyholders not less in amount than the paid-in capital required under this title of a domestic stock insurer, other than a limited stock insurer, authorized to transact like kinds of insurance. A domestic limited stock life insurer may accept reinsurance of the risks of other such limited stock insurers and of domestic benefit insurers.

"B. An insurer shall so reinsure in such alien insurers only as either are authorized to transact insurance in at least one state of the United States, or have in the United States a duly authorized attorney-in-fact to accept service of legal process against the insurer as to any liability which might arise on account of such reinsurance.

"C. No credit shall be allowed, as an asset or as a deduction from liability, to any ceding insurer for reinsurance unless the reinsurance is payable by the assuming insurer on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer nor unless under the reinsurance contract the liability for such reinsurance is assumed by the assuming insurer or insurers as of the same effective date."

* * * * *

[8] § 20-506

"B. The director may require that such reserves be equal to the unearned portions of the gross premiums in force after deducting reinsurance in solvent insurers as computed on each respective risk from the policy's date of issue. If the director does not so require, the portions of the gross premiums in force, less reinsurance in solvent insurers to be held as a premium reserve, shall be computed according to the following table:"

* * * * *

losses had eaten into the 3 percent, this would have been American Bankers' loss, not plaintiff's.

Defendant then argues that even if Treaty II is operative, plaintiff would have to re-establish the reserve as an offsetting liability to the asset required under paragraph 8 of § 20–501 of the Arizona law. That section is directed primarily toward loss reimbursements for losses paid directly by the ceding company. Therefore, there is no asset belonging to plaintiff because plaintiff does not have an enforceable claim of right against American Bankers.

We observe that the Arizona Code relating to insurance companies provided under § 20–152 for the director of insurance to certify the facts of violation of any provision to the attorney general for enjoining the violation. We also observe that the Georgia Code relating to insurance companies provided under § 56–214 that the Commissioner may institute legal proceedings for the enforcement of any provisions of the act. For the years in question, none of these actions were taken by either of the state officers in charge. With relation to doubtful or ambiguous statutes, it is generally accepted that in the absence of a court decision, the interpretation placed thereon by the regulatory body charged with enforcement thereof is compelling authority. Federal courts have applied this rule to state administrative interpretations or actions under state statutes. We believe that the language of the court in *Salt Lake County* v. *Kennecott Copper Corp.*, 163 F. 2d 484, 489 (10th Cir. 1947) *cert. denied*, 333 U.S. 832, adopting a state administrative interpretation of an ambiguous state statute, is pertinent herein:

> * * * Both the Supreme Court of Utah and this court are firmly committed to the familiar principle of law that in the interpretation of a doubtful or ambiguous statute, the long-continued and uniform interpretation of the administrative agency or authority charged with its administration is entitled to great weight and will not be overturned, except for cogent reasons. An administrative interpretation does not avail to overcome a statute which is so plain in its commands that it leaves nothing for construction; but ordinarily in case of doubt or ambiguity, it is entitled to great weight and will not be overthrown, except for cogent reasons. *State Board of*

> *Land Commissioners* v. *Ririe*, 56 Utah 213, 190 P. 59; *Utah Hotel Co.* v. *Industrial Commission*, 107 Utah 24, 151 P. 2d 467, 153 A.L.R. 1176; *Utah Power & Light Co.* v. *Public Service Commission*, 107 Utah 155, 152 P. 2d 542; *E. C. Olsen Co.* v. *State Tax Commission*, Utah, 168 P. 2d 324; *Baze* v. *Scott*, 10 Cir., 106 F. 2d 365; *United States* v. *Magnolia Petroleum Co.*, 10 Cir., 110 F. 2d 212; *Standard Surety & Casualty Co.* v. *State of Oklahoma*, 10 Cir., 145 F. 2d 605. * * *

We believe that the Court's language in *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 139–140 (1944), explains the basic reason for the rule and we deem it appropriate in the present case:

> There is no statutory provision as to what, if any, deference courts should pay to the Administrator's conclusions. And, while we have given them notice, we have had no occasion to try to prescribe their influence. The rulings of this Administrator are not reached as a result of hearing adversary proceedings in which he finds facts from evidence and reaches conclusions of law from findings of fact. They are not, of course, conclusive, even in the cases with which they directly deal, much less in those to which they apply only by analogy. They do not constitute an interpretation of the Act or a standard for judging factual situations which binds a district court's processes, as an authoritative pronouncement of a higher court might do. *But the Administrator's policies are made in pursuance of official duty, based upon more specialized experience and broader investigations and information than is likely to come to a judge in a particular case. They do determine the policy which will guide applications for enforcement by injunction on behalf of the Government. Good administration of the Act and good judicial administration alike require that the standards of public enforcement and those for determining private rights shall be at variance only where justified by very good reasons.* The fact that the Administrator's policies and standards are not reached by trial in adversary form does not mean that they are not entitled to respect. This Court has long given considerable and in some cases decisive weight to Treasury Decisions and to interpretative regulations of the Treasury and of other bodies that were not of adversary origin. [Emphasis supplied.]
>
> We consider that the rulings, interpretations and ooinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do

> constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.

See *New York State Department of Social Services* v. *Dublino*, 413 U.S. 405, 420–421 (1973); *NLRB* v. *Boeing Co.*, 412 U.S. 67, 74–75 (1973); *CBS* v. *Democratic National Committee*, 412 U.S. 94, 121 (1973); *Trafficante* v. *Metropolitan Life Insurance Co.*, 409 U.S. 205, 210 (1972); *Udall* v. *Tallman*, 380 U.S. 1, 16–18 (1965); *Travelers Indemnity Co.* v. *Wells*, 316 F. 2d 770, 773 (4th Cir. 1963); *Barrington Manor Apartments Corp.* v. *United States*, 198 Ct. Cl. 298, 304, 459 F. 2d 499, 502–503 (1972); *Alabama* v. *United States*, 198 Ct. Cl. 683, 692, 461 F. 2d 1324, 1329–30, *cert. denied*, 409 U.S. 1023 (1972); *Inter-City Truck Lines, Ltd.* v. *United States*, 187 Ct. Cl. 290, 295, 408 F. 2d 686, 688 (1969); *Cornman* v. *United States*, 187 Ct. Cl. 486, 492, 409 F. 2d 230, 233, *cert. denied*, 396 U.S. 960 (1969); *DeLano* v. *United States*, 183 Ct. Cl. 379, 388, 393 F. 2d 517, 521 (1968); *Ganse* v. *United States*, 180 Ct. Cl. 183, 189, 376 F. 2d 900, 904 (1967); *Citizen Band of Potawatomi Indians* v. *United States*, 179 Ct. Cl. 473, 486–487, 391 F. 2d 614, 621 (1967), *cert. denied*, 389 U.S. 1046, 390 U.S. 957 (1968); *Crawford* v. *United States*, 179 Ct. Cl. 128, 142–143, 376 F. 2d 266, 274–275 (1967), *cert. denied*, 389 U.S. 1041 (1968); *cf. Federal Maritime Commission* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 745 (1973); *Love* v. *Fitzharris*, 460 F. 2d 382, 385 (9th Cir. 1972), *vacated*, 409 U.S. 1100 (1973).

Finally, with relation to the testimony of Mr. Sturtevant, who testified that the unearned premium reserve as reported by American Bankers and plaintiff was permitted "unwittingly" by the Georgia insurance authorities, we have reviewed his testimony and it does not change our interpretation of the Georgia law above expressed.

For the foregoing reasons, we hold that the plaintiff is entitled to recover.

NICHOLS, *Judge*, dissenting:

The dissent in *Penn Security Life Insurance Company* v. *The United States*, *ante* at 594, is to be deemed as being applicable to this case.

## FINDINGS OF FACT

### *History of the Controversy*

1. For each of the taxable years 1958 through 1965, plaintiff filed a timely tax return and paid all taxes shown thereon to be due. The taxes paid in said years were as follows:

1958: $48,144.32
1959: $72,405.55
1960: $52,377.05
1961: $17,777.24
1962: $17,047.52
1963: $43,790.32
1964: $17,726.51

Such tax liability of plaintiff in all such years was computed in accord with Section 802 of the Internal Revenue Code of 1954.

2. Under date of February 20, 1969, the Acting Regional Commissioner, Internal Revenue Service, Southeast Region, sent plaintiff a notice of deficiencies in federal income taxes in the aggregate amount of $233,762.75, plus interest, for the taxable years ended December 31, 1958, 1959, 1960, 1962, 1963, and 1964. (Recomputation for 1961 resulted in a refund due plaintiff.) The statement accompanying said notice of deficiency set forth the reasons for the alleged deficiencies in federal income taxes as follows:

> "It is determined that for your taxable years 1958, 1959, 1960, 1962, 1963 and 1964, you did not qualify as a life insurance company within the meaning of section 801 of the Internal Revenue Code of 1954, entitling you to taxation under section 802 of the 1954 Code. Consequently, your taxable income is being computed under Section 832 of the 1954 Code. This determination is based on the following:
>
> "(1) You did not compute or estimate your life insurance reserves on credit life contracts on the basis of a recognized Mortality Table and assumed rates of interest, as required by section 801(b) of the 1954 Code, and/or
>
> "(2) You did not reflect in your total reserves, defined in Section 801(c) of the 1954 Code certain unearned premiums on accident and health contracts under cer-

tain reinsurance agreements which should have been included therein. Accordingly, when your total reserves are corrected, your life insurance reserves as reported, even if recognized as having been computed or estimated on a basis of a recognized mortality table, would not exceed 50% of your correct total reserves pursuant to section 801(a) of the 1954 Code."

3. On or about July 30, 1969, plaintiff paid to the District Director the aggregate amount of $351,393.88 additional federal income taxes and interest thereon for the taxable years ended December 31, 1958, 1959, 1960, 1962, 1963, and 1964.

4. On or about October 14, 1969, plaintiff filed with the District Director Claims for Refund of taxes and interest in the respective amounts and for each of the taxable years as described in paragraph 3 above. On or about June 26, 1970, plaintiff filed amended Claims for Refund of taxes and interest in the respective amounts and for each of the taxable years as described in paragraph 3 above.

5. On or about October 27, 1970, the District Director notified plaintiff that the aforesaid amended Claims for Refund for the overpayment of taxes and interest had been disallowed.

6. Plaintiff filed its Petition in this Court on December 30, 1970, for recovery of income taxes and interest paid by plaintiff with respect to its claims for its taxable years 1958, 1959, 1960, 1962, 1963, and 1964.

7. Jurisdiction over the subject matter of this action is conferred upon this Court under Section 1346(a)(1), Title 28, United States Code.

### *Background of Controversy*

8. Plaintiff was incorporated as a stock insurance company under the Insurance Code of the State of Arizona on June 26, 1957.

9. Since its incorporation, all of the outstanding stock of plaintiff has been owned by Southern Discount Company (hereinafter referred to as "Southern Discount"), which was during all years pertinent to this lawsuit a Georgia

corporation licensed under the consumer finance laws of the states in which it operated, and was engaged in the consumer finance business. These state laws forbade Southern Discount from acting as an insurance company. They did, however, permit Southern Discount to act as an agent for other insurance companies.

**10.** Prior to the incorporation of plaintiff, Southern Discount acted as agent for various insurance companies who wrote insurance on the lives and health of Southern Discount's borrowers.

**11.** Credit life and accident and health insurance is sold in connection with a loan of money or an installment sale of tangible personal property. Credit life insurance, generally defined, is term insurance on the lives of debtors, with their creditors as beneficiaries, in amounts at least sufficient to discharge their indebtedness in case of death. Sometimes the life coverage is combined with accident and health coverage. Such coverage pays the debtor's monthly installments during the period within the policy term in which he is totally disabled (*i.e.*, unable to work) because of accident or sickness, provided that the disability lasts beyond a minimum or "waiting" period. Coverage may be conditioned upon the permanent as well as total disability of the debtor. When life and accident and health coverage are provided in one contract, the respective premiums are separately stated.

**12.** As agent in the sale of such insurance, Southern Discount was able to share in its profitability by earning a commission, the amount of which, however, was limited by state law. By causing plaintiff to be formed, Southern Discount was able to participate to a greater degree in the profitability of this business, when it was profitable, by actually engaging in the insurance underwriting function either directly or through its reinsurance.

**13.** The initial capital and paid-in surplus upon the incorporation of plaintiff in 1957 was $38,000.00. In 1959 plaintiff's stated capital was increased by $175,000.00 so as to qualify plaintiff to write insurance in the State of Georgia.

**14.** Plaintiff's Articles of Incorporation provide, among other powers designated therein, that the nature of the business, and objects or purposes to be transacted, promoted or carried on are:

> "(a) To insure, in its own proper and corporate name, the lives of persons and all insurance appertaining thereto, including, but not limiting the generality of the foregoing: term, industrial, retirement income, ordinary, modified, single premium, limited payment, group and all other types and forms of contracts of insurance upon or relating to the lives of persons in connection with the extension of credit to such persons.
>
> (b) To reinsure all or a part of any risk, class of risks, or all of the risks of the Company with any other insurance company or companies, and to accept such reinsurance from any other insurance company or companies, as allowed by law."

**15.** During all of the taxable years in issue in this case, plaintiff was licensed by the Insurance Commissioner of the State of Arizona to transact life and disability insurance business. During the taxable years in issue the Arizona Department of Insurance conducted regular examinations of plaintiff's business activities and reports of examination were issued in 1959 and 1963.

**16.** American Bankers Life Assurance Company (hereinafter referred to as "American Bankers") is an insurance company licensed to engage in the life and disability insurance business under the laws of the State of Florida.

**17.** Other than as a party to certain treaties described more particularly below, American Bankers was totally unrelated to plaintiff at its inception and has remained an unrelated company except for its ownership of a nominal amount of stock (approximately 2½%) in plaintiff's parent corporation, Southern Discount, from March 15, 1962, until March 25, 1969, and approximately 1% acquired in 1972 and disposed of in the following year.

**18.** Reinsurance is a transaction in which an insurance company (the writing company, or ceding company) transfers, at least temporarily, the responsibility for all or a portion of the claims on which it may eventually be liable under the policies it has written, to another company (the reinsurer). The ceding company pays the reinsurer consideration for assisting the ceding company in spreading, or averaging, its liabilities or risk over time. Reinsurance may be entered into for numerous reasons, including freeing one company's capital or surplus from restrictions imposed for reserves required, spreading risks over time, avoiding catastrophic losses, the alliance of a small, new company with an older, experienced company for business purposes, sharing profitability of the industry where business considerations require that, and avoiding fluctuations of yearly earnings.

**19.** During the years 1958 through 1961, plaintiff's business consisted of reinsuring all policies of insurance against the death or disability of debtors of Southern Discount and certain of its subsidiaries, which insurance policies had been issued by American Bankers. For plaintiff to have written insurance directly, rather than to have acted as a reinsurer, plaintiff would have been required to possess total stated capital and capital surplus of some $400,000.00 at this time in the State of Georgia. Plaintiff's intent was to act as a reinsurer, permissible with a smaller capital investment, and increase its surplus through the profitability of the business until plaintiff could qualify to write insurance directly. This method of conducting business relieved Southern Discount, plaintiff's parent company, from the financial burden of contributing to plaintiff's capital a large amount of cash and thereby enabled Southern Discount to utilize its available cash to produce a more attractive return through its consumer lending business.

**20.** This reinsurance was effected pursuant to the terms of a reinsurance treaty entered into by the parties and dated June, 1957, which agreement was amended from time to time thereafter. (This period is hereafter referred to as "Period I" and this treaty and its amendments as "Treaty I." See paragraphs 56–58.)

**21.** The reinsurance treaties executed by plaintiff and American Bankers were arm's-length agreements entered into for valid business purposes by unrelated parties.

**22.** American Bankers realized that if Southern Discount created a subsidiary insurance company which operated alone or under reinsurance treaties with other companies, the insurance business generated by loans on Southern Discount's customers would be lost completely by American Bankers.

23. In 1962, plaintiff having qualified to write insurance directly in the States of North Carolina and Georgia, its primary business became the direct writing of life and accident and health insurance on the debtors of Southern Discount and certain of its subsidiaries. This business continued to be plaintiff's primary business throughout the remainder of the years in issue ("Period II"), although plaintiff continued to reinsure certain policies under Treaty I until they expired according to their terms.

24. A certain percentage of the accident and health policies written directly by plaintiff during Period II were reinsured by American Bankers pursuant to the terms of a Reinsurance Treaty entered into between the parties on April 18, 1962. ("Treaty II." See paragraphs 59–61.)

25. Treaty II was entered into by plaintiff and American Bankers in 1962 for valid business reasons. The cession to American Bankers, on an "as written" basis, as described below, of a majority of the credit accident and health insurance which plaintiff wrote meant that plaintiff was not required under state law to maintain any unearned premium reserves on said insurance. Had full reserves, in the amount of 100% of the unearned premiums, been maintained by plaintiff with respect to said insurance, plaintiff's earnings and the consolidated earnings and capital of Southern Discount would have been adversely affected, with consequent damage to Southern Discount's borrowing power, which was of great import in its primary business.

26. Treaty II was an arms-length agreement between plaintiff and American Bankers. In addition to its effect on plaintiff's reserve requirements, Treaty II permitted plaintiff to dilute the effect on its capital and surplus at any given time, of accident and health insurance claims, thus serving the traditional role of reinsurance in deferring risk and providing protection for plaintiff and its customers in the event of any catastrophic loss experience, since American Bankers' obligations under the treaty were not limited in any way.

### *Qualification as a Life Insurance Company*

27. Section 801 of the Internal Revenue Code of 1954 provides an objective test for determining whether an insur-

ance company is a "life insurance company" and therefore permitted to report its income in the method prescribed by Section 802. The qualification formula may be expressed in terms of the following fraction, the quotient of which must be more than 50 percent in order for an insurance company to qualify as a life insurance company.

| Qualifying reserves (numerator) | ÷ | Total reserves (denominator) |
|---|---|---|
| 1. Tabular reserves on life, annuity, and non-cancellable accident and health policies | | 1. Tabular reserves on life, annuity, and noncancellable accident and health policies |
| 2. Unearned premiums on noncancellable life, health, or accident policies not included in (1) | | 2. Unearned premiums not included in (1) |
| 3. Unpaid losses on noncancellable life, health, or accident policies not included in (1) | | 3. Unpaid losses not included in (1) |
| | | 4. All other insurance reserves required by law. |

**28.** Plaintiff did not physically hold, nor did it exercise control over, those unearned premiums representing accident and health insurance reserves which the Commissioner of Internal Revenue attributed to plaintiff for purposes of measuring plaintiff's "total reserves." The accident and health reserves were held by American Bankers and the investment income therefrom received by it.

**29.** Plaintiff maintained life insurance reserves with respect to life insurance reinsured pursuant to Treaty I. Similarly, plaintiff maintained life insurance reserves with respect to life insurance written by plaintiff during Period II.

**30.** Historically, life insurance reserves are maintained by an insurance company to enable the company to pay those claims which may reasonably be expected to result from the life insurance policies it has issued. The computation of life insurance reserves is based upon mortality tables which contain statistics as to average life expectancies for certain ages and sexes. By applying these statistics to the ages and sexes represented by a company's actual policyholders, a reasonably accurate prediction of the amount necessary to meet future claims may be made. (Although the amount will vary according to the mix of policyholders for any particular company, the amount of reserves normally required was approximately 40 percent of premiums received for the policies covered by Treaty I.)

31. Traditionally, whether because accident and health insurance exposure was initially incapable of being measured statistically (although records have been maintained sufficiently by this time that a reasonable reserve requirement could probably be reached by using statistics), or perhaps because this insurance, unlike life insurance, is usually cancellable, accident and health reserves are required to be computed in terms of how much of a premium would have to be refunded to a policy holder in the event the policy were cancelled at any particular time during its term. The reserve so maintained is referred to as the "unearned premium reserve." This method of establishing reserves is the established method of computing reserves for health and accident insurance.

32. All credit life and credit accident and health policies issued by American Bankers and reinsured by plaintiff, and those issued by plaintiff and reinsured by American Bankers, provided for payment of the entire premium at the time of issuance. This is referred to in the industry as "single premium" payment. When a health and accident premium under such a "single premium" policy is first paid by the insured, it is wholly "unearned" in that the entire premium has been paid for coverage over the full term of the policy, which has not yet been provided. Such unearned portion is set aside on the books and records of the company as the unearned premium reserve. As the term of the policy expires with the passage of time, the premium becomes "earned" to the extent of such expiration, since that portion was paid for coverage which was provided during the expired portion of the policy.

33. An unearned premium reserve thus measures an insurance company's reserve requirements by looking to premiums already paid by policyholders and then determining the portion of such premiums that represent payment for insurance to be provided after the reserve valuation date.

34. In the event that the policies issued by American Bankers or by plaintiff to the debtors, in Period I or II, were cancelled by some act prior to the expiration of their original terms, the refund of the unearned portion of the premiums

would be made in pursuance to their terms in accordance with a prescribed formula known as the Rule of 78.

**35.** Under the Rule of 78 or "sum-of-the-digits" method, the unearned premium is computed by applying changing fractions each year (or month, if unearned premiums are determined monthly) to the premium paid by the insured. The numerator of the fraction changes each year (or month) to a number which corresponds to the sum of the digits of the remaining unexpired term (years or months) of the policy, and the denominator, which remains constant, is the sum of all the years' (or months') digits corresponding to the entire term of insurance coverage. For example, if an insured debtor paid a \$300 premium for disability benefits at the inception of a three-year single premium policy, he would be entitled to a refund under the Rule of 78 of \$300 $\left(\frac{3+2+1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the first year, \$150 $\left(\frac{2+1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the second year, and \$50 $\left(\frac{1}{3+2+1}\times\$300\right)$ if the policy was terminated at the beginning of the third year.

**36.** The unearned premium reserve for accident and health insurance is therefore 100 percent of the gross accident and health premium at the outset of a policy term. It is impossible for an insurance company to maintain such a reserve unless it has other funds besides the premium in question, since other costs such as the agent's commission and administrative expenses must also be paid from the same premium. Even with other funds the restriction on capital imposed by such a reserve requirement is severe.

**37.** It has become customary in the industry to structure reinsurance treaties (which serve other valid business purposes of leveling the peaks and valleys in a particular company's liability pattern) in such a way that the larger, high-capital party to the treaty maintains the reserves required for any accident and health insurance involved. Thus the party whose capital can bear the burden of the restriction imposed by "unearned premium reserves" will physically hold those reserves and collect the investment income from them.

**38.** The result of plaintiff's treaties with American Bankers was that plaintiff was not required to maintain reserves for the accident and health insurance reinsured or written directly by it, to the extent said business was subject to those treaties.

**39.** In Treaty I, the accident and health insurance written by American Bankers was reinsured by plaintiff on a month-to-month basis, as it became "earned." The single premium received by American Bankers at the creation of the policy was held by American Bankers and remitted on a monthly basis, net of a 12½% retention, to plaintiff, as payment for the reinsurance being provided to American Bankers. American Bankers maintained the "unearned premium reserves" on said policies; plaintiff maintained no reserves. Plaintiff's obligation to reimburse American Bankers for insurance claims incurred was limited in the aggregate to the amount it received from American Bankers according to the treaty.

**40.** Plaintiff was not required by the state regulatory agencies to establish an unearned premium reserve with respect to its reinsurance of American Bankers' accident and health insurance policies under Treaty I because as of each payment from American Bankers to plaintiff, all such reinsurance premiums had been fully earned by plaintiff, and no portion of the reinsurance premiums received and held by plaintiff represented payment for insurance to be provided after the payment date.

**41.** Under Treaty II, plaintiff reinsured 80 percent (and later 65 percent) of the accident and health insurance, which it now wrote directly, with American Bankers. This reinsurance was not ceded on a month-to-month basis as earned, but all at once from the outset of the policy term. Plaintiff therefore remitted the entire premium, less commissions to agents, for the portion reinsured to American Bankers initially. American Bankers' obligation to reimburse plaintiff for insurance claims incurred was not limited in any way. American Bankers, holding the premiums, therefore established the reserves required for such insurance. Plaintiff established no such reserves.

42. Plaintiff was not required by any state regulatory agency to establish any unearned premium reserves as to insurance ceded by it to American Bankers under Treaty II because plaintiff held no unearned premiums on such policies, but instead received credit for reserves properly established by American Bankers, which did hold those premiums.

43. The unearned premiums and corresponding reserves in question under both treaties were physically held by American Bankers, which received the investment income therefrom, and which reported said reserves for purposes of state regulation as well as taxation. Plaintiff did not obtain or use the unearned premiums reflected in the annual statements of American Bankers, nor were said unearned premiums credited, set apart, or made available to plaintiff. There was no common or direct control of American Bankers by plaintiff or vice versa.

44. There was no existing state law which would have had the effect of "attributing" to plaintiff any reserves held by American Bankers on the insurance which was the subject of Treaties I and II. As unrelated parties to arm's-length agreements, both plaintiff and American Bankers received benefits and gave consideration for said benefits under these treaties. The unearned premiums received by American Bankers were subject to no control or other proprietary interest on the part of plaintiff.

45. Under Treaty I, plaintiff had no obligation to refund premiums paid by policyholders of American Bankers in the event of premature termination of policies issued by American Bankers, since plaintiff received such premiums only after they had been fully earned. Consequently, there was no need, either legal or practical, for plaintiff to establish an unearned premium reserve for the purpose of maintaining a fund available for the refund of premiums.

46. Under Treaty II, since American Bankers received the accident and health premiums before they were earned, and since American Bankers' obligation to bear the cost of claims was not limited in any way, American Bankers properly maintained unearned premium reserves as to the portion of such policies reinsured.

**47.** The treaties in question and the method of maintaining reserves pursuant thereto were not unusual in the insurance industry at this time, and are still in use. The maintenance of said reserves was proper from an actuarial and an accounting point of view. It is standard in reinsurance accounting that the company which possesses the unearned premiums is the only company required to maintain the reserves thereon, unless one of the companies is not a qualified reinsurer.

**48.** The insurance industry is regulated by the states. A particular insurance company must meet the various industry requirements of its home state, and must satisfy the requirements of all states in which it is qualified to act as an insurer. The state requirements include standards for investments, maintenance of reserves, and accounting practices. The state insurance departments surpervise policy forms, agency relationships, and the general financial activities of the companies within their jurisdictions. This regulation is designed to preserve the solvency of the insurance companies for the protection of policyholders.

**49.** To implement their regulatory function, state insurance departments require companies to file annual reports. Because reports are required in all states in which a company is qualified to act as an insurer, a standard report form has been developed by the National Association of Insurance Commissioners, which is used in all fifty states. These reports disclose, among other things, the reserves being maintained by each company.

**50.** In addition to requiring annual reports, the various state insurance departments conduct regular triennial examinations of insurance companies. Where the volume of business warrants it as to a particular company, it is customary for representatives of several state insurance departments to work together on these examinations. The examinations are carried out at the offices of the company in question, and may take as long as several months for large companies. Among the matters which are investigated in the course of such an examination are the reinsurance treaties to which a particular company is a party.

51. When a state insurance department is presented with a reinsurance agreement in existence between parties, its investigation will include a determination that each party has established adequate reserves according to its respective liabilities pursuant to the terms of the reinsurance agreement.

52. Plaintiff was the subject of triennial examinations in 1959 and 1963 by the insurance department of Arizona.

53. American Bankers was the subject of triennial examinations in 1960 and 1963. Participants in the 1960 examination were from the insurance departments of Florida, North Carolina, Georgia, and Texas; and participants in the 1963 examination were from the insurance departments of Florida, Georgia, Arizona, and Arkansas.

54. The reinsurance treaties between plaintiff and American Bankers were examined in detail in the course of the aforesaid examinations. The existence of reserves for accident and health insurance held by American Bankers on the policies covered by those treaties was clear to the examiners. Also the maintenance of the reserves by American Bankers under the treaties during Period I and Period II was approved in the course of the four examinations; no requirement or even suggestion was made in the examination reports that the reserves should be otherwise maintained.

55. There is no federal law pertaining to the matters of regulation which constitute the responsibility of the various states as described above.

56. Insofar as pertinent to this litigation, Treaty I read as follows:

### ARTICLE I

> American Bankers agrees to cede to *Consumer Life* and *Consumer Life* agrees to accept reinsurance to the extent set forth below:
>
> One Hundred Per Cent (100%) of each and every Life policy and each and every Health and Accident policy (herein called "Life policies" and "Health and Accident policies") issued by American Bankers in respect to debtors of *Consumer Life* and its subsidiary and affiliated corporations. The liability of *Consumer Life* under said Life and Health and Accident policies shall follow the liability of American Bankers except that the liability of *Consumer Life* arising under its reinsurance of said Health and Accident policies is on a month to

month basis only and is limited solely to such amounts as shall become payable by *Consumer Life* under the provisions of Article V prior to the termination of this agreement.

## ARTICLE II

This agreement applies to all said policies issued by American Bankers on or after the *1st* day of *July*, 1957.

## ARTICLE III

American Bankers shall furnish *Consumer Life* on or before the 20th day of *July*, 1957 and on or before the 20th day of each month thereafter, a statement showing the following information on transactions of the preceding month:

A. On all Life policies the statement will show:

(1) The amount of premiums collected;

(2) The amount of premiums returned on account of cancellation or other reason; and

(3) The amount of losses paid.

B. On all Health and Accident policies the statement will show:

(1) The amount of premiums collected;

(2) The amount of premiums returned on account of cancellation or other reason;

(3) The amount of losses paid;

(4) The amount of losses reported and unpaid and the estimated amount of losses incurred and unreported at the end of the preceding month; and

(5) The amount of premiums earned.

For the purpose of computing premiums earned during any month on Health and Accident policies under this Article III, the sum of the premiums collected on policies written during the month less any premium returned because of cancellation or other reason during the month, shall be added to the unearned premium reserve at the beginning of the month on policies then in force, and from the total sum so obtained shall be subtracted the unearned premium reserve at the end of the month on policies in force at that time.

For the purpose of computing losses, losses reported and unpaid and losses incurred and unreported, the allocated loss expense shall be added to the amount of loss claims. In this connection the allocated loss expense shall be all claim expenses over and above the usual claim expenses incurred in the routine handling of a claim in the ordinary course of business, it being the intent of the parties hereto to include such expenses as the hiring of a special investigator, unusual travel expense in connection with the handling of a claim, attorney's fees arising from a claim and other expenses not incurred in the usual and ordinary course of handling a claim.

## ARTICLE IV

In addition to the monthly statement set forth in Article III, American Bankers agrees to furnish *Consumer Life* on or before the 20th day of January each year and from time to time as may be requested by *Consumer Life*, but in no event more often than monthly, a statement containing the following information as at the end of the month preceding the statement:

A. The amount of reserve on all life policies then in force;

B. The amount of losses on Life policies reported and unpaid and the estimated amount of losses incurred but unreported;

C. The amounts of insurance on all Life policies;

D. Such other information as may be required to complete annual statements or other statements as required by law.

*Consumer Life* shall, at all reasonable times during this agreement, have full and free access to all books, records and files of American Bankers' office with respect to the business covered by this agreement.

## ARTICLE V

In consideration of the reinsurance as set forth in Article I, the American Bankers agrees to pay monthly to *Consumer Life*, based on the statement set forth in Article III for the preceding month, and payable at the same time: (1) Eighty-seven and One-half Per Cent (87½%) of the premiums collected less any premiums returned on all Life policies, and (2) Eighty-seven and One-half Per Cent (87½%) of the premiums earned on all Health and Accident policies.

*Consumer Life* agrees to reimburse American Bankers before the 30th day of the month after such statement is submitted, for all losses actually paid during the preceding month on Life policies and all losses actually paid during the preceding month on Health and Accident policies plus any increase or less any decrease during said month in the amount of Health and Accident losses reported and unpaid and incurred and unreported.

## ARTICLE VI

American Bankers shall maintain all unearned premiums, loss and other reserves as may be required by law against all Health and Accident policies. *Consumer Life* shall maintain policy and other reserves as may be required by law on all Life policies.

## ARTICLE VII

American Bankers agrees to pay all state, county, or city taxes which may be or become due in connection with the insurance sold or premiums collected on policies reinsured under this agreement.

## ARTICLE VIII

American Bankers has furnished to *Consumer Life* and *Consumer Life* has acknowledged having received from American Bankers specimen forms upon which all said policies covered hereby are currently written. American Bankers reserves the right to make changes in such forms from time to time, but shall promptly notify *Consumer Life* of all such changes.

## ARTICLE IX

The supervision and payment of all claims on policies covered by this agreement shall be handled by American Bankers and the decision of American Bankers in settling, rejecting or defending such claims shall be binding on *Consumer Life.*

## ARTICLE X

In the event of the insolvency of the American Bankers, all reinsurance shall be payable directly to the liquidator, receiver or statutory successor of said American Bankers, without diminution because of the insolvency of American Bankers.

In the event of insolvency of American Bankers, the liquidator, receiver or statutory successor shall give *Consumer Life* written notice of the pendency of a claim on the policy reinsured within a reasonable time after such claim is filed in the insolvency proceeding. During the pendency of any such claim, *Consumer Life* may investigate such claim and interpose in the name of American Bankers (its liquidator, receiver or statutory successor,) but at its own expense, in the proceeding where such claims are to be adjudicated, any defense or defenses which *Consumer Life* may deem available to American Bankers or its liquidator, receiver or statutory successor.

## ARTICLE XI

All disputes and differences between the two contracting parties upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitrators, who shall regard this agreement from the standpoint of practical business and equity rather than from that of the strict law, are empowered to determine as to the interpretation of the agreement obligation.

The court of arbitrators which is to be held in the city of Miami, Florida, shall consist of three arbitrators who must be officers of life insurance companies other than the two parties of this agreement. One of the arbitrators is to be appointed by American Bankers, the second by *Consumer Life* and the third is to be selected by these two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators be unable to agree upon the choice of a third, the appointment shall be left to the president of the American Life Convention.

The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration, including the fees of the arbitrators, shall be borne by the losing party unless the arbitrators shall decide otherwise.

## ARTICLE XII

This agreement constitutes the entire contract between the parties and may not be altered, modified or in any ways amended except by an instrument in writing duly executed by the proper official of both parties.

## ARTICLE XIII

This agreement may be terminated by either party effective on the last day of any month upon at least thirty (30) days written notice of the other party.

Upon termination by either party, this agreement shall continue to apply to all policies reinsured hereunder before such termination becomes effective.

IN WITNESS WHEREOF, the parties hereto have caused this instrument to be signed and sealed by their duly authorized officers on this *28* day of *June*, 1957.

**57.** By amendments effective November 1, 1957 and April 1, 1958, American Bankers' retained share of the total premiums received annually in excess of $200,000 was reduced from 12½ percent, as provided in Article V of Treaty I, finding 56, *supra*, to 9½ percent.

**58.** Treaty I was further amended May 28, 1958, effective as of July 1, 1957, to revise the extent of plaintiff's interim liability as the reinsurer of American Bankers' exposure under the A & H coverages subject to the Treaty. At all times, however, plaintiff reinsured the entire risk represented by those coverages, the only change being in the timing of its loss indemnity payments to American Bankers. At the time of this amendment plaintiff had accumulated a surplus fund of $130,000 from A & H premium receipts out of which to meet its reinsurance obligations which were averaging approximately $3,000 per month.

**59.** Treaty II is recited in toto. It read as follows:

> ### ARTICLE I
>
> #### *Basis of Reinsurance*
>
> 1. On and after the effective date hereof, the Ceding Company's liability under Credit Accident and Sickness policies issued directly by the Ceding Company on the policy forms specified in Schedule A, attached hereto, shall be reinsured automatically to the degree and in the manner hereinafter specified.
>
> 2. The reinsurance liability of American Bankers during 1962 shall be 80% of each policy issued by the Ceding Company; thereafter, with respect to new business, such reinsurance liability may be reduced at the option of the ceding company at the beginning of each subsequent calendar year.
>
> 3. Reinsurance hereunder shall apply and be subject to all benefits and limitations included in policies issued by the Ceding Company and subject to reinsurance hereunder.
>
> ### ARTICLE II
>
> #### *Mode of Cession*
>
> 1. Reinsurance of Credit Accident and Sickness insurance issued or renewed by the Ceding Company on and after the effective date of this Agreement shall be effected

by the Ceding Company's mailing to American Bankers a reinsurance cession on a form of which a sample is attached hereto and marked Schedule B, not later than the twentieth day following the last day of the calendar quarter covered by the reinsurance cession. The liability of American Bankers shall:

(a) commence as of the effective dates of the reinsurance premiums, and

(b) continue only for the period covered by the reinsurance premiums.

2. In no event shall the reinsurance be in force and binding unless the policy issued by the Ceding Company to the insured is in force.

## ARTICLE III

### *Reinsurance Premiums*

1. The reinsurance premiums to be paid the American Bankers by the Ceding Company shall be the premiums charged the insured by the Ceding Company during the calendar quarter for the coverage reinsured.

2. The American Bankers will pay to the Ceding Company a commission of 50% of reinsurance premiums received, as specified in this Article, on reinsurance hereunder.

## ARTICLE IV

### *Oversights*

1. American Bankers shall be bound as the Ceding Company is bound, and it is expressly understood and agreed that if non-payment of premiums within the time specified or failure to comply with the terms of this Agreement is shown to be unintentional and the result of misunderstanding or oversight on the part of either the Ceding Company or American Bankers, both the Ceding Company and American Bankers shall be restored to the positions they would have occupied had no such error or oversight occurred.

## ARTICLE V

### *Payment of Claims*

1. At the end of each calendar quarter American Bankers shall reimburse the Ceding Company for American Bankers share of all claim payments made by the Ceding Company during the calendar quarter on policies reinsured hereunder.

2. It is hereby understood and agreed that the American Bankers shall be liable only for claims incurred on or after the effective date hereof.

## ARTICLE VI

### *Experience Refunds*

1. Reinsurance ceded hereunder shall be eligible for an Experience Refund. The Experience Refund for a given calendar quarter shall be computed as follows:
Experience Refund = (P–Co–E–Cl)

where P = earned reinsurance premiums during the calendar quarters as determined by American Bankers.
Co = earned reinsurance commissions during the calendar quarter as determined by American Bankers.
E = an expense, profit, and contingency charge equal to .03P.
Cl = incurred reinsurance claims during the calendar quarter as determined by American Bankers.

2. If P–Co–E–Cl is negative for a given calendar quarter such negative amount will be treated as an addition to the incurred claims in calculating the Experience Refund for the following calendar quarters.

## ARTICLE VII

### *Taxes, Assessments and Expenses*

Neither party hereto shall be liable to the other for taxes, assessments, or any expenses resulting from reinsurance hereunder. The Ceding Company shall furnish the American Bankers with all necessary information so that American Bankers will not be required to perform any office work other than the regular bookkeeping entries made in connection with reinsurance accounting.

## ARTICLE VIII

### *Inspection of Records*

American Bankers shall have the right at any reasonable time to inspect at the office of the Ceding Company all books and documents relating to the reinsurance under this Agreement.

## ARTICLE IX

### *Insolvency*

1. In the event of insolvency of the Ceding Company, all reinsurance in force shall be payable to its liquidator or receiver without diminution because of the insolvency of the Ceding Company by any court of competent jurisdiction or any justice or judge thereof, or by any receiver or liquidator having authority to determine and allow such claims. It is understood, however, that in the event of the insolvency of the Ceding Company, the liquidator, receiver or statutory successor of the Ceding Company shall give written notice of the pendency of a claim against the Ceding Company on the policy reinsured with[in] a reasonable time after such claim is filed in the insolvency proceedings and that during the pendency of such claim the American Bankers may investigate such claim and interpose, at its own expense, in the proceedings where such claim is to be adjudicated any defense or defenses which it may deem available to the Ceding Company or its liquidators or receiver or statutory successor.

2. The expense thus incurred by American Bankers shall be chargeable against the Ceding Company as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to the Ceding Company solely as a result of the defense undertaken by American Bankers.

## ARTICLE X

### *Settlement of Claims*

1. American Bankers shall be liable to the Ceding Company for the benefits covered by reinsurance hereunder to the same extent as the Ceding Company is liable to the insured for such benefits and all reinsurance shall be subject to the terms and conditions of the particular form of policy under which the Ceding Company shall be liable.

2. It is hereby understood and agreed that the American Bankers shall be liable only for claims incurred on or after the effective date hereof.

3. Whenever a claim is made under a policy of the Ceding Company, which has been reinsured hereunder, it shall be taken and considered by American Bankers to

be a claim for the amount of reinsurance on such risk and American Bankers shall abide the issue as it shall be settled by the Ceding Company and shall pay the amount of reinsurance covered by the policy of reinsurance when the Ceding Company shall settle with the Claimant.

4. Any suit or claim may be contested or compromised on the part of the Ceding Company and in case of a reduction of the claim made upon the Ceding Company, American Bankers and the Ceding Company shall participate in such reduction in the ratio that each company's net liability bore to the total net liability prior to the reduction of the claim. Any unusual expenses incurred by the Ceding Company in defending or investigating any claims or taking up or rescinding any policy reinsured hereunder aside from routine investigations and other expenses incidental to the settlement of claims shall be shared in the same proportion.

5. In every case of loss, copies of proofs obtained by the Ceding Company shall likewise be taken as sufficient by American Bankers and copies thereof, together with a statement showing the amount paid on such claim by the Ceding Company shall be furnished to American Bankers before payment shall be demanded of it.

## ARTICLE XI

### *Arbitration*

1. All disputes and differences between the two contracting parties upon which an amicable understanding cannot be reached are to be decided by arbitration and the arbitrators, who shall regard this treaty from the standpoint of practical business and equity rather than from that of the strict law, are empowered to determine as to the interpretation of the treaty obligation.

2. The court of arbitrators which is to be held in the City of Miami, Florida, shall consist of three arbitrators who must be officers of life insurance companies other than the two parties of this Agreement. One of the arbitrators is to be appointed by the Ceding Company, the second by American Bankers and the third is to be selected by those two representatives before the beginning of the arbitration. Should one of the parties decline to appoint an arbitrator or should the two arbitrators be unable to agree upon the choice of a third, the appointment shall be left to the counsel for the Consumer Credit Insurors Association.

3. The arbitrators are not bound by any rules of law. They shall decide by a majority of votes and from their written decision there can be no appeal. The cost of arbitration, including the fees of the arbitrators, shall be borne by the losing party unless the arbitrators shall decide otherwise.

### ARTICLE XII

#### *Parties to Agreement*

This is an agreement solely between the Ceding Company and American Bankers. The acceptance of reinsurance hereunder shall not create any right or legal relation whatever between American Bankers and the insured or the beneficiary under any policy of the Ceding Company which may be reinsured hereunder.

### ARTICLE XIII

#### *Duration*

1. This agreement shall be effective as of the 1st day of March 1962, and may be terminated as of the end of any calendar quarter by either party giving to the other not less than 30 days' written notice.

2. Upon termination, as provided in this Article, the Ceding Company shall, within 30 days of the termination date, supply American Bankers with the information necessary to calculate the final experience refund as of the termination date. Payment of (a) the final experience refund, (b) the unearned premium reserve held by American Bankers less unearned commissions thereon, and (c) payment of the claim reserve held by American Bankers.

**60.** On December 2, 1964, effective October 1, 1964, plaintiff and American Bankers executed the following amendment to Treaty II:

### ADDENDUM TO REINSURANCE AGREEMENT

THIS AGREEMENT, made this 2nd day of December, 1964, and effective the 1st day of October, 1964, by and between CONSUMER LIFE INSURANCE COMPANY OF PHOENIX, ARIZONA, hereinafter designated as "Ceding Company" and AMERICAN

BANKERS LIFE ASSURANCE COMPANY OF FLORIDA, a corporation duly organized and existing under and by virtue of the laws of the State of Florida and having its executive office in the City of Miami, and State of Florida, hereinafter designated as "Company".

WITNESSETH:

WHEREAS, the Company and the Ceding Company entered into a Reinsurance Agreement on the 1st day of March, 1962; and

WHEREAS, the parties are mutually desirous of amending said Agreement as hereinafter set forth.

NOW, THEREFORE, IT IS MUTUALLY UNDERSTOOD AND AGREED AS FOLLOWS:

1. The terms and conditions of said Reinsurance Agreement are incorporated within the terms of this Agreement.
2. Article I, Paragraph (2) is hereby amended to read: The reinsurance liability of American Bankers shall be 65% of each policy issued by the Ceding Company; thereafter, with respect to new business, such reinsurance liability may be reduced at the option of the Ceding Company at the beginning of each subsequent calendar year.
3. All other conditions are to remain the same.

**61.** On December 29, 1964, effective December 31, 1964, plaintiff and American Bankers executed the following further amendment to Treaty II:

AMENDMENT TO Reinsurance Agreement between Consumer Life Insurance Company of Phoenix, Arizona, and American Bankers Life Assurance Company of Florida, of Miami, Florida, dated April 18, 1962.

Article VI of above mentioned Reinsurance Agreement is hereby amended to read as follows:

### ARTICLE VI

#### *Experience Refunds*

1. Reinsurance ceded hereunder shall be eligible for an Experience Refund. The Experience Refund for a given calendar quarter shall be computed as follows:

Experience Refund = (P–Co–E–Cl–N)

where P = earned reinsurance premiums during the calendar quarter as determined by American Bankers.
Co = earned reinsurance commissions during the calendar quarter as determined by American Bankers.
E = an expense, profit, and contingency charge equal to .03P.
Cl = incurred reinsurance claims during the calendar quarter as determined by American Bankers.
N = negative carry-forward from prior quarter.

2. If a negative amount is obtained from the calculation of the Experience Refund for a given calendar quarter, such negative amount will be carried forward in calculating the Experience Refund for the following calendar quarter, provided, however, that any unamortized balance of such negative carry-forward will be dropped from the refund calculation after 20 quarters. The "first-in, first-out" principle will apply to the unamortization of two or more negative carry-forwards arising from the experience of different calendar quarters.

IN WITNESS WHEREOF the parties hereto have caused this Amendment to be executed in duplicate this 29th day of December, 1964, and to be effective for calculating the Experience Refund due for the calendar quarter ending December 31, 1964.

### ULTIMATE CONCLUSION OF FACT

**62.** Unearned premiums and the corresponding reserves held pursuant to Treaty I are not includable in planitiff's "total reserves" for purposes of Internal Revenue Code Section 801.

**63.** Unearned premiums and the corresponding reserves held pursuant to Treaty II are not includable in plaintiff's "total reserves" for purposes of Internal Revenue Code Section 801.

**64.** Plaintiff qualified as a life insurance company for purposes of Section 801 because its life insurance reserves exceeded 50 percent of its total reserves, as that term is defined in Section 801(c), as shown by plaintiff's income tax returns for the years 1958, 1959, 1960, 1962, 1963, and 1964.

### CONCLUSION OF LAW

Upon the foregoing opinion and findings of fact, which are made a part thereof, the court concludes as a matter of law that plaintiff is entitled to recover; and judgment is entered to that effect, with the determination of the amount of recovery to be made in further proceedings under Rule 131(c).

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524 F. 2d 1194

# AGWAY, INC., SUCCESSOR TO COOPERATIVE GRANGE LEAGUE FEDERATION EXCHANGE, INC. v. THE UNITED STATES

[No. 302-72. Decided October 22, 1975]

### ON DEFENDANT'S AND PLAINTIFF'S MOTIONS FOR SUMMARY JUDGMENT

**Taxes; income tax; corporate distributions and redemption of stock; capital gains and losses; inventory v. capital asset; stock purchase to insure source of supply.**—Plaintiff is a Delaware corporation operating as a farmers' cooperative and is the successor by statutory merger as of July 1, 1964 to Cooperative Grange League Federation Exchange, Inc. (Exchange) which had operated for many years, including 1960, as a farmers' cooperative. Exchange's principal business was the manufacture and purchase of farm supplies, equipment and petroleum products and the sale of such items either directly to its farmer patrons or to various retail outlets which, in turn, sold them to farmers. Exchange kept its books on an accrual basis with a July 1–June 30 fiscal year. In 1937 Exchange became a patron of United Co-Operative, Inc. (United), an Indiana farmers' cooperative corporation exempt from taxation under Sec. 521 of the Internal Revenue Code of 1954 and its predecessor sections. United was required to provide its patrons with supplies and services at cost, plus necessary expenses. During each fiscal year United sold goods and services to its patrons at prices generally prevailing in the market place, and at the end of its fiscal year the excess of revenue over expense in United's hands was refunded to its patrons in the form of United's $100 par value preferred stock, United being legally obligated to repay the amount represented by the preferred stock. On October 31, 1957 United issued shares of its $100 par value preferred stock to plaintiff and others. Pursuant to agreement with the Internal Revenue Service on audit, plaintiff took this stock into income at $60 per share and so reported it. In February 1960 United redeemed a portion of the outstanding preferred stock through a cash distribution to plaintiff. This suit seeks a tax refund, including statutory interest, for fiscal year ending June 30, 1960, the issue before the court being whether plaintiff's monetary gain on the redemption of the preferred stock is taxable as ordinary income or as capital gains (long-term). For the reasons given, and in distinguishing *Corn Products Ref. Co.* v. *Commissioner*, 350 U.S. 46 (1955), and in view of *United States* v. *Mississippi Chemical Corp.*, 405 U.S. 298 (1972), it is *held* that when the preferred stock was redeemed at a figure in excess of its 1957 fair market value, plaintiff's gain was a capital gain, following the Fifth Circuit decisions in *Tomlinson* v. *Massey*, 308 F. 2d 168 (1962), and *Raley* v. *United States*, 491 F. 2d 136 (1974). Defendant's motion for summary judgment is denied, plaintiff's cross-motion is granted, and the case is remanded to the trial division for further proceedings for determination of the amount of plaintiff's recovery.

**Taxes; income tax; corporate distributions and adjustments; redemption of stock.**

[1] In determining whether share redemption is "essentially equivalent to a dividend" for purposes of Sec. 302(b)(1) of the 1954 Internal Revenue Code, the hallmarks of a dividend are pro rata distribution of earnings and profits and no change in basic shareholder relationships.

Internal Revenue 🔑 364

**Taxes; Treasury Regulations; retroactive application of.**

[2] Under 26 U.S.C. § 7805(b) the Secretary of the Treasury or his delegate is authorized to limit retroactive effect, not to add retroactive effect that a regulation otherwise would not have. Thus, the changes embodied in Treas. Reg. 1.61–5(c) promulgated in December 1959 providing that amounts allocated to customers by cooperatives on patronage basis shall be ordinary income in the case of redemption of stock to the extent of the excess over the amount previously taken into income, cannot be applied retroactively to previously issued paper or stock of the subject cooperative where such retroactive application is contrary to the statute then governing.

Internal Revenue 🔑 173

**Taxes; income tax; corporate distributions and adjustments; sale or exchange; tax benefit rule.**

[3] Where A, a farmers' cooperative, purchased goods at market price from tax-exempt agricultural cooperative U (required by statute to sell its goods at cost plus necessary expenses), and A received back from U a part of the purchase price in the form of shares of U, which shares had been assigned an agreed value (less than U's par value) by A and the Internal Revenue Service, and A thus realized more on subsequent sale or exchange, the tax benefit rule which is of judicial origin is inapplicable to such a situation

because gains of this kind are always foreseen as possible and the tax laws make full provision therefor.

Internal Revenue ⚷ 452

**Taxes; income tax; capital gains and losses; inventory v. capital asset; stock purchase to insure source of supply; congressional intent.**

[4] The doctrine of *Corn Products Ref. Co.* v. *Commissioner*, 350 U.S. 46 (1955), will be applied in this court to purchases of company stock to obtain a source of supply only if there is no substantial investment intent. Thus, in the present case involving the floating of paper in a farmers' cooperative prior to changes incorporated in Treas. Reg. 1.61–5(c) and the law, where the necessity of the cooperative in floating its paper to its participants derived from the requirements of Congress pursuant to Sec. 521(b)(2) of the 1954 Code, the intent of the participant in joining the cooperative system was essentially the intent of Congress in creating it, and therefore the participant could not be heard to say his subjective intent in purchasing the stock was other than what Congress meant to bring about.

Internal Revenue ⚷ 409.2

**Judgments; former adjudications; stare decisis.**

[5] *Stare decisis* ought to apply in tax cases to the result as well as the reasoning used to reach it, even if more weakly, and it should not be readily avoided by new legal contentions that could have been made in the prior case. That is, the legal status of, *e.g.*, cooperative paper, ought not to vary from tribunal to tribunal merely according to the arguments Government counsel chooses to make.

Courts ⚷ 96(7)

*Mac Asbill, Jr.*, attorney of record for plaintiff. *William A. Sutherland*, *James F. Jorden*, *Rufus E. Brown*, and *Sutherland, Asbill & Brennan*, of counsel.

*Charles E. Auslander, Jr.*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Theodore D. Peyser*, *John E. Evans*, of counsel.

Before DURFEE, *Senior Judge*, NICHOLS and KASHIWA, *Judges.*

NICHOLS, *Judge*, delivered the opinion of the court:

This tax refund suit for $28,044.19 (and statutory interest) comes before the court on cross motions for summary judgment on the sole remaining issue in the case: whether plaintiff's $43,480 gain on the redemption of preferred stock in an agricultural cooperative is taxable as ordinary income or as capital gains (long-term).

The stock that was redeemed in taxpayer's 1960 fiscal year, at $100 face value per share, was originally issued in 1957, valued by plaintiff and defendant then at $60 per share on audit after extended negotiations, and taken into income at that figure. Plaintiff contends that the $40 per share gain on the redemption of the stock over its 1957 fair market value (FMV) of $60 is either a capital gain or a tax-free, basis-reducing return of capital. Defendant contends that the $40 per share gain is simply ordinary income to plaintiff for a series of reasons discussed below. Plaintiff has paid the tax assessed and sues for refund. We hold for plaintiff that its gain is a capital gain, following the Fifth Circuit decisions in *Tomlinson* v. *Massey*, 308 F. 2d 168 (1962); and *Raley* v. *United States*, 491 F. 2d 136 (1974).

## I

Plaintiff is a Delaware corporation, doing business as a farmers' cooperative in New York and successor since July 1, 1964, to Cooperative Grange League Federation Exchange, Inc., which was both organized as a New York corporation and did business in New York. Exchange's principal business for the tax year in question was the manufacture and purchase of farm supplies, equipment and petroleum products and the sale of such items either directly to its farmer patrons or to various retail outlets which, in turn, sold them to farmers. Exchange kept its books on an accrual basis with a July 1–June 30 fiscal year. It is Exchange's 1960 fiscal year (July 1, 1959–June 30, 1960) that is in issue. Hereinafter the word "Exchange" may refer to plaintiff, and vice versa.

Plaintiff was also a patron of United Co-Operatives, Inc., organized as an Indiana farmers' cooperative corporation. United operates on an accrual basis using a November 1–October 31 fiscal year, making its patronage refunds annually on approximately October 31. This case concerns the stock transactions between United and plaintiff.

Article 7 of United's By-laws governed the stock transactions in issue, and so far as relevant provides as follows: (1) Section 5 (of Article 7) makes all capital contributions (including plaintiff's preferred stock before redemption) "subject to all the risks and contingencies incident to the investment of capital in corporations." (2) Section 6 requires patronage refunds to be paid annually on the basis of a single year's volume of business. (3) Section 7 allows patronage refunds to be paid out in a wide variety of forms, including cash, stock, and other "paper". (4) Section 10 requires that capital contributions be assessed on the basis of the last *3 years* volume of business. (5) Section 11 allows patronage refunds to be used to meet capital contributions—the patrons receiving "paper" or stock in lieu of cash as a result of crediting patronage refunds to obligatory capital contributions. (6) Section 13 acknowledges the cooperative's obligation to pay back eventually all net margins and capital contributions to the patrons (assuming the cooperative stays solvent). (7) Sections 14 and 15 qualify this pay-back right by reserving to the Board of Directors' judgment the decision when and if to pay back retained profits and capital contributions. Capital advances are retired in the order received.

During Exchange's fiscal year 1960, the following stock transactions with United occurred:

> 1. About October 31, 1959, United distributed 2,193 shares of preferred stock to Exchange as part of its annual patronage refund pursuant to Article 7 of the By-laws.
> 2. About February 1, 1960, United redeemed 1,087 shares of preferred stock from Exchange for $108,700. The redeemed stock had been acquired about October 31, 1957, as part of the annual patronage refund for that fiscal year of United.

The following table displays the effects of these two stock transactions on Exchange's share of United's preferred stock:

| | *Shares* | *Percentage of outstanding stock* |
|---|---|---|
| Before Oct. 31, 1959 | 3, 480 | 17. 4 |
| After Oct. 31, 1959 | 5, 673 | 18. 0 |
| After Feb. 1, 1960 | 4, 586 | 16. 1 |

During this same fiscal year 1960 Exchange held a constant total of 100 shares of Class A common stock also, which at all times was less than 6% of the outstanding Class A common stock. Exchange held no Class B common stock during this period.

The exclusive voting rights were in the A stock. The C stock (preferred stock) was freely transferrable. It paid dividends not over 4% per annum. On liquidation, the C stock, plus accumulated dividends took precedence over common stock and patronage distributions.

Joint Exhibit K, which lists plaintiff's transactions in the preferred stock (issued as patronage refunds by United) discloses the uncertain nature of preferred stock redemptions:

| *Preferred Stock Fiscal Years* | *Issued* | *Redeemed* |
|---|---|---|
| 1942–1953 | About 4,000 shares | 42 shares. |
| 1954–1956 | None | About 3,000 shares. |
| 1957–Jan. 1960 | About 5,700 shares | About 1,500 shares. |

Thus the capital needs of United resulted in Exchange holding about 5,000 shares at the end of 19 years membership in United. All previous redemptions had effectively been cancelled by subsequent stock patronage refunds, prior to the stock redemption here about February 1, 1960. Defendant has offered no specific evidence to establish any motive of tax avoidance or tax evasion in the operation of the above stock issuance and redemption program.

The adjustment on audit of 1957 taxes reflected an addition of $60 a share to plaintiff's ordinary income.

## II

The first substantial issue in this case is to determine the applicable Code Section of Subchapter C of the 1954 Internal Revenue Code (IRC, also Title 26 of USC).

Although defendant makes a point that we should totally reject Subchapter C, as governing, because United was not a for-profit corporation, no statutory or case law citations are presented to support such an extraordinary contention. Further it is clearly stipulated that plaintiff and United both operated as corporations under their respective state laws. No evidence to support a holding that the corporations were mere shells or dummies is presented. Consequently the defendant's assertions are rejected without further consideration.

Plaintiff presents two alternative arguments: one is that the transactions are to be treated as true capital-gain redemptions under Subchapter C, § 302; the other is that the redemptions are to be treated as non-dividend distributions under § 301. These arguments cannot both be right. Under § 301(a), § 301 does not apply if the chapter otherwise provides. In § 302 it does so otherwise provide (with certain stated exceptions) in the case of a redemption. The definition in § 317(b) holds that if a corporation acquires its stock from a shareholder in exchange for property (which includes money) it is a redemption.

The facts of this case establish that plaintiff's redemption of stock (by United) is in § 302(b)(1) language a redemption "not essentially equivalent to a dividend." As a consequence plaintiff is not excluded from § 302(a) capital gain treatment, assuming (as discussed below) plaintiff meets other statutory requirements for capital asset as opposed to non-capital asset treatment. By § 302(b)(5) meeting this test suffices though other tests under (b)(2), (3) and (4) are not met. By § 302(d), § 301 applies only if § 302(a) does not apply, but here it does apply because of § 302(b)(1).

The test for what is "essentially equivalent to a dividend" (for purposes of § 302(b)(1)) was discussed at length in *Himmel* v. *Com'r*, 338 F. 2d 815 (2d Cir. 1964). The court stated a twofold test, at 817:

> The hallmarks of a dividend, then, are pro rata distribution of earnings and profits *and* no change in basic shareholder relationships.

It has already been noted that the redemption shifted plaintiff's portion of the outstanding stock only from 18.0% to 16.1%, a mere 1.9% shift which is not "substantially disproportionate" § 302(b)(2), and a non-significant change in basic shareholder relationships under the facts of this case. However, the By-laws effectively preclude meeting the first part of the twofold test: pro rata distribution.

A pro rata distribution would occur only if every stockholder had X number of shares redeemed for every share of preferred stock held. This cannot be.

Section 14 of Article 7 of the By-laws requires that "capital advances shall be retired in the order in which they have been received." All or the same proportion of all shares issued in a single year must be redeemed together.

Under Section 14, the only way a distribution could be pro rata across the class of stock is if every stockholder received the same number of shares in each year of issue.

To receive the same number of shares in each year of issue, under Section 10 of Article 7 of the By-laws, each shareholder must do exactly the same amount of business volume every year "for the last three years," for the same number of three year periods (over at least the 1942–1960 period that plaintiff participated).

This, in fact, has not occurred. Patrons do differing amounts of business each year. Patrons come and go from the cooperative. Thus the redemptions here involved cannot be dividends.

This case is easily distinguishable from § 302(b)(1) cases involving corporations with related shareholders where "attribution" under § 318 applies. *See*, *United States* v. *Davis*, 397 U.S. 301 (1970); *Albers* v. *Com'r*, 414 U.S. 982 (1973), dissent to refusal of certiorari to reconsider *Davis* by Justices Douglas, Blackmun, and Powell). It is clear from the prevailing opinion in *Davis* that in the absence of attribution the result would be the same as here.

(Our result here also meets plaintiff's counsel's prelitigation expectations. See footnote 2, Mac Asbill, Jr., "1962 Act: New tax on coops will bring drastic changes in operation, financing," 17 Journal of Taxation, 325–326 (1962). Counsel wrote: "It would seem that, in the normal case, the gain realized on disposition of the stock would be capital gain. * * * *See Tomlinson* v. *Massey*, * * *".)

Under authority of *Tomlinson* v. *Massey*, *supra*, and *Raley* v. *United States*, *supra*, and agreeably to the above analysis, the plaintiff should therefore be taxed at capital gains rates unless the defendant prevails with one of the three reasons it has adduced for taking the case out of the general rule and making the gains ordinary income.

## III

Defendant's first argument is that its 1959 changes in the Regulations should be applied. The Regulation, Treasury Regulation on Income Tax, § 1.61–5, published December 3, 1959, provides that amounts allocated to customers by cooperatives on a patronage basis shall be ordinary income, to the extent of fair market value in the case of stock and in case of redemption of stock, to the extent of the excess over the amount previously taken into income.

The Congress by Pub. L. 87–834, 76 Stat. 1045, IRC §§ 1381–1388, effective December 31, 1962, amended the statute in the same substance as the Regulation, so the instant controversy cannot now arise.

The defendant's argument relies on IRC § 7805(b) which provides:

> * * * The Secretary or his delegate may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

This statute authorizes him to limit retroactive effect, not to add retroactive effect that a Regulation would otherwise not have.

The Regulation specified its own retroactivity (U.S. Code & Adm. News Fed. Tax Reg. (1960) p. 72 § 1.61–5(c)):

> * * * If, for any taxable year ending before the date of publication of this paragraph in the Federal Register as a Treasury Decision, a taxpayer treated any patronage dividend received in the form of a document * * * in accordance with the regulations then applicable * * * such taxpayer is not required to change the treatment of such patronage dividends for any such prior taxable year. * * *

With respect to paper issued before 1959 both *Tomlinson* and *Raley*, *supra*, denied application to the change in Regulations in 1959, which made an about face from treating patronage dividend paper as a capital asset for redemption purposes to treating it as an ordinary income asset at redemption, though in *Raley* the redemption was after 1959. This result was based on general retroactivity principles and the view that the attempted retroactive application was contrary to the statute then governing.

We also join the Fifth Circuit in rejecting such retroactive application of the 1959 Regulations. For reasons elaborated below, we think the situation presents an exceptionally strong case for application of *stare decisis*, and for not going into conflict.

## IV

Defendant next seeks to apply the tax benefit rule to this case. However, defendant misreads the rule.

The tax benefit rule is of judicial origin and has been applied to several types of situations. Application here would lack support in decided cases and be wrong on principle.

Three cases arose under the provisions of IRC §§ 336 and 337 for non-recognition of gains or losses in corporate liquidations: (a) *Citizens Federal S. & L. Ass'n of Cleveland* v. *United States*, 154 Ct. Cl. 305, 290 F. 2d 932 (1961); (b) *West Seattle Nat'l Bank of Seattle* v. *Com'r*, 288 F. 2d 47 (9th Cir. 1961); and (c) *Anders* v. *United States*, 199 Ct. Cl. 1, 462 F. 2d 1147, *cert. denied*, 409 U.S. 1064 (1972).

Both *Citizens* and *West Seattle* applied the tax benefit rule to require unused bad debt reserves to be taken as income in the year of liquidation of the bank, despite §§ 336 and 337. *Anders* went beyond the statute to exclude from § 337 nonrecognition treatment the bulk sale of certain inventory items (towels) that taxpayer had already fully "expensed" and reduced to a zero basis (by deducting as a business expense rather than a capital investment). In *Anders* the court was following the same result as achieved in the companion case, *Com'r* v. *Anders*, 414 F. 2d 1283 (10th Cir.), *cert. denied*, 396 U.S. 958 (1969).

In *Arrowsmith* v. *Com'r*, 344 U.S. 6 (1952), taxpayers who had been taxed on gains from liquidating a corporation at the capital gains rate were held required to treat as a capital loss sums they later paid as transferees to settle an unforeseen liability of the same corporation.

In *Dynamics Corp. of America* v. *United States*, 196 Ct. Cl. 282, 449 F. 2d 402 (1971), we held that a payment to compromise a lawsuit, otherwise deductible as an ordinary and necessary business expense, was not deductible to the extent it was essentially a refund of a dividend, on which the 85% corporate dividends received credit had been taken.

Two other cases of the unexpected return type are *United States* v. *Skelly Oil Co.*, 394 U.S. 678 (1969), and *Alice Phelan Sullivan Corp* v. *United States*, 180 Ct. Cl. 659, 381 F. 2d 399 (1967). In *Skelly Oil* taxpayer was allowed a deduction for a court-ordered rebate to customers (on petroleum sales) only to the extent that these amounts had not been previously exempted from tax under the oil depletion allowance. In *Alice Phelan*, we held that the return of a charitable gift for which a deduction had been taken (through unexpected failure of the trust) resulted in income to the donor.

The tax benefit rule has no application in decided cases to a situation where an asset is given on audit a value for some tax purpose, and the taxpayer realizes more on subsequent sale or exchange. There is no need for courts to formulate a rule here because gains of this kind are always foreseen as possible, and the tax laws make full provision for them. Here we are being asked to substitute a rule of our formulation for the one Congress has prescribed.

## V

Defendant asserts that we should apply the "*Corn Products* doctrine". *Corn Products Refining Co.* v. *Com'r*, 350 U.S. 46 (1955). The Court held that partial hedging transactions, purchase of corn futures (to guard against price rise only), by a manufacturer, whose raw material is the commodity being traded, are treated as if they were inventory and not as a capital asset, notwithstanding the definition of "capital asset" in IRC § 1221 and its predecessor which does not literally exclude the futures in the list of exclusions such as stock in trade, etc. Gains and losses on disposal of futures not required in the business were therefore ordinary income or loss.

*Corn Products* has been applied in lower courts in a variety of situations which possibly might surprise the *Corn Products* court, and we are concerned with only one of these ramifications here, and may properly disregard all the others. This is the "source of supply" line of cases holding or refusing to hold that when a taxpayer acquires stock of another company to obtain a dependable source of supply of components for manufacture, or articles for sale, such a purchase is or is not an ordinary expense of the business rather than a capital investment. Cases in this court are: *Booth Newspapers, Inc.* v. *United States*, 157 Ct. Cl. 886, 303 F. 2d 916 (1962); *FS Services, Inc.* v. *United States*, 188 Ct. Cl. 874, 413 F. 2d 548 (1969); *Waterman, Largen & Co.* v. *United States*, 189 Ct. Cl. 364, 419 F. 2d 845 (1969), *cert. denied*, 400 U.S. 869 (1970); and *Dearborn Co.* v. *United States*, 195 Ct. Cl. 219, 444 F. 2d 1145 (1971).

The obvious argument for defendant here is that taxpayer had no intent to invest in the preferred stock and acquired it only as an unavoidable incident to using United as a source of supply. Unlike the cases cited, however, the record here offers no direct evidence of taxpayer's subjective intent. Presumably defendant would treat all holders of the stock alike whatever their private thoughts about it might have been.

The first three cases cited above follow *Corn Products* to hold that purchases of stock of suppliers was without investment intent and therefore, losses on resale were ordinary and not capital losses, sustaining, of course, the taxpayer's position. *Dearborn* holds to the contrary. It is therefore pertinent to the instant case to determine how we distinguished the facts there found from the three prior holdings.

In *Dearborn* the court held that in purchasing stock in a woodwork company plaintiff, a furniture company, though partly seeking a dependable source of supply had "substantial investment purpose" (195 Ct. Cl. at 224, 444 F. 2d at 1148), in that it intended to operate the company "as a permanent, profitable business in its own right", to "receive dividend income", and to make fee income from managing the new subsidiary. The stock acquisition was meant to be permanent, not to be sold when the components ceased to be in short supply.

In *Waterman, Largen* the stock purchase was to obtain a source of employment of the plaintiff company as a commission selling agent of wool and synthetic yarns. The court, accepting plaintiffs' testimony as to their subjective intent, found from this and from surrounding circumstances, including the unattractiveness of the stock as an investment, that plaintiffs did not have investment intent. No language can be found stating there was no investment intent at all, but the majority could not have deemed such intent substantial or the same judges would not, just a year and a half later, have decided *Dearborn* as they did. *See* Finding 29 in *Waterman, Largen.*

The rule can be stated to be, and we believe is, that *Corn Products* will be applied in this court to purchases of company stock to obtain a source of supply, only if there is no substantial investment intent. It is futile to analyze the cases in further detail because it is obvious that determining intent will involve very different considerations when the stock is acquired, not all at once, but intermittently as part of the patronage refunds of a cooperative, and where obtaining control is not a factor. Since the necessity of taking refunds in part in paper is inherent in purchasing from such a cooperative, our search for the decisive intent is transferred to the decision to purchase through the cooperative system, and away from the acceptance of the paper, which has become unavoidable. In fact, one can go further and say the intent in joining such a scheme is essentially, the intent of Congress in creating it, and therefore, the participant could not be heard to say his subjective intent was other than what Congress meant to bring about. The necessity of the cooperative floating its paper to its customers derives from the requirements of Congress, IRC § 521(b)(2).

Defendant's *Corn Products* analysis here is thus contrary to and refuted by *United States* v. *Mississippi Chemical Corp.*, 405 U.S. 298 (1972). In that case the taxpayers, cooperatives, borrowed money at low interest rates from one of the statutory Banks for Cooperatives, and, under the law, were required to buy class C stock quarterly in the bank, in a fixed amount measured by the amount loaned. This stock paid no dividends and virtually had no market. Taxpayers contended it really represented additional interest, and except for a nominal amount its purchase price was deductible as interest. The case before us now was suspended to await the result in the Supreme Court in the *Mississippi Chemical* case. The Supreme Court held the stock was a § 1221 capital asset, and said that, viewing it as part of the statutory scheme as a whole, it had real value to the cooperative to which it was issued. Congress might have just required a higher interest, but the parties could not participate in the scheme and yet reject the form in which Congress chose to cast it. *Corn Products* is not mentioned expressly, but it is clear that the Supreme Court could not have applied the analysis it did, if it had deemed that *Corn Products* applied, nor could it have said the stock was a § 1221 capital asset.

Our previous decision to the contrary on almost identical facts, *Penn Yan Agway Coop.* v. *United States*, 189 Ct. Cl. 434, 417 F. 2d 1372 (1969) is referred to in a footnote in the *Mississippi Chemical Corp.* case, and must be regarded as disapproved. Neither party cites it here and we do not think it is necessary to convene an *en banc* court to overrule it formally.

It is also worth noting that the plaintiff here filed a brief amicus in the *Mississippi Chemical* case.

In *Tomlinson* v. *Massey*, *supra*, the United States cited *Corn Products* to support its argument that the cooperative paper there involved was not a capital asset, but the court held it was. This paper was sold at 20% of face, not redeemed, and as it had no ascertainable market value up to its sale, unlike the paper here, defendant's argument here would seem to have less plausibility than it had there. *Raley* v. *United States*, *supra*, does not expressly refer to *Corn Products* but may be deemed to approve the part of the previous decision dealing with *Corn Products*, as it does other parts. The court in *Raley* mentions in its fn. 2 that the case now before us was, according to information furnished by the Attorney General, the only case of the kind pending in any court of the United States.

The fundamental error with the defendant's argument for the *Corn Products* doctrine is that, if the doctrine were applied by us solely on the strength of a cooperative's serving as a supplier to its patrons, (and the argument has no other basis) we would be effectively holding that cooperatives and their patrons could not hold capital stock as a capital asset, and this would be a fundamental change in the tax law without any statutory justification. It would negate § 521 (b)(2) and render the 1962 amendments (§§ 1381–1388) needless. We find no statutory support for such a change, and we are given no compelling precedent of the Supreme Court either. Rather, as the Court did in *Mississippi*, we seek the result that best conforms with existing statutes laid down by Congress. Congress is the lawmaker—not we in the judiciary.

## VI

This case is an example of the defendant's relitigation policy, which has recently been harshly criticized in the *Preliminary Report of the Commission on Revision of the Federal Court Appellate System* (April 1975) A–92 and ff. Since defendant came before us on issues it had lost (or failed to raise) in but one other court, this is not an extreme example in that regard. Compare our recent unpublished order in *National Life Ins. Co.* v. *United States*, No. 85–72, June 27, 1975, citing four previous losses by defendant on the issue there litigated.

This case is peculiar however, in that if the information given the Firth Circuit in *Raley*, *supra*, was correct, this is the very last case involving the tax status of pre-1959 cooperative paper. Defendant in 1962 had the applicable law rewritten to its specifications, so the issue as presented here has no current importance. The case has attractiveness as one for the tax buff to sharpen his perceptions on, and that may be why defendant has labored so hard to bring about a conflict between the last and next to last cases in this field.

The plaintiff has not asked us to extend the collateral estoppel doctrine of *Blonder-Tongue Labs.* v. *University of Illinois Foundation*, 402 U.S. 313 (1971) to tax litigation. If the *Commission on Revision* is right, the evils the Supreme Court took arms against in *Blonder-Tongue* obtain equally here. No doubt, however, it would require a tribunal having the powers the Supreme Court enjoys to overrule past precedent, to make the extension suggested. It may occur some day. The limited impact of collateral estoppel in Federal tax cases under present decided law is illustrated in *Phipps* v. *United States*, 206 Ct. Cl. 583, 515 F. 2d 1099 (1975). Meanwhile, we think that for the lower courts a deference to *stare decisis* that would otherwise seem exaggerated, not a defiance of the principle, is our best defense against needless litigation. As to other Federal courts, our reluctance to go into conflict should be likewise great.

A characteristic of the relitigation policy not mentioned by the *Commission* is the assertion of new legal grounds in relitigated cases. *National Life Ins. Co.*, *supra*, affords an example of this, and so is the invocation here of the tax benefit rule. We think *stare decisis* ought to apply in tax cases to the result as well as the reasoning used to reach it, even if more weakly, and it should not be readily avoided by new legal contentions that could have been made in the prior case. That is, the legal status of, *e.g.*, cooperative paper ought not to vary from tribunal to tribunal merely according to the arguments Government counsel chooses to make.

Our use of the precedents in this and other courts has been in accordance with the above stated principles.

### CONCLUSION

Accordingly the defendant's motion for summary judgment is denied. The plaintiff's motion for summary judgment is allowed, and the cause is remanded to the trial division for further proceedings under Rule 131(c) to determine the amount of the judgment to be entered for the plaintiff.

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DURFEE, *Senior Judge*, concurring in part and dissenting in part:

I concur with the result in the majority opinion by Judge Nichols. Judge Kashiwa, in his dissent, agrees with the majority that "the rule can be stated to be, and we believe is, that *Corn Products* will be applied in this court to purchase of company stock to obtain a source of supply *only if there is no substantial investment intent*", *infra.* p. 698, (Emphasis supplied).

Apart from any distinction drawn by Judge Kashiwa from *United States* v. *Mississipi Chemical Corp.*, 405 U.S. 298 (1972) and the present case, the Court there did say, "The stock has value because it is the foundation of the corporate scheme; it insures stability and continuity." 405 U.S. at 311. Judge Kashiwa's opinion is that "the stock involved in *Agway* does not provide a foundation and stability for United. On the contrary, it is intended that the patronage dividend stock be redeemed when the capital is considered adequate. This is in the by-laws." *Infra*, p. 700.

When plaintiff paid for market value for the products it purchased from United Cooperative, rather than their actual cost to United, this was a capital investment by which plaintiff acquired its preferred stock, not merely a purchase of corn futures designed to protect itself against price increases and to insure its continued supply requirements as intended in *Corn Products.* In my opinion, the value of plaintiff's preferred stock was that it did "insure stability and continuity" and "the foundation of the corporate scheme", so considered in *Mississippi Chemical Corp.*

Article 7, Sec. 5 of the by-laws, *also* provided that all capital contributions, including plaintiff's preferred stock before redemption are "subject to all the risks and contingencies incident to the investment of capital in a corporation." Under the *Corn Products* rule that we agree is to be applied "to the purchase of company stock to obtain a source of supply", this by-law supplies convincing evidence of "substantial investment intent."

I do not join in Judge Nichols' criticism of the "defendant's relitigation policy which has recently been harshly criticized in the Preliminary Report of the Commission on Revision of the Federal Court Appellate System (April 1975) A-92 and ff." Part VI, p. 696, *supra.* With all deference to this Preliminary Report and to application of the rule of *stare decisis* for lower courts, and since this is the very last case involving the tax status of pre-1959 cooperative paper, I believe that any extensive criticism of the Government's defense as "an example of defendant's relitigation policy", may well await another day and another case more effective as future precedent.

KASHIWA, *Judge*, dissenting:

My only point of dissent with the majority opinion is the application of the Corn Products[1] doctrine to this case. The majority states, and I agree that:

> The rule can be stated to be, and we believe is, that *Corn Products* will be applied in this court to purchases of company stock to obtain a source of supply only if there is no substantial investment intent.

The majority then looks at the intent involved in the decision to purchase through the cooperative system. However, the majority opinion does not look at the taxpayer's intent but transfers the intent to Congress under Int. Rev. Code of 1954, § 521(b)(2) making it necessary for a cooperative to float its paper to its customers. The majority analyzes *United States* v. *Mississippi Chemical Corp.*, 405 U.S. 298 (1972), and seems to conclude that since the Supreme Court examined the case based on Congressional intent in setting up the Banks for Cooperatives and since the Court did not apply *Corn Products*, it is not applicable in the present case, or perhaps in any case, where there is Congressional involvement.

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[1] *Corn Products Refining Co.* v. *Comm'r,* 350 U.S. 46 (1955).

However, *Mississippi Chemical* is very much distinguished from *Agway*. The Banks for Cooperatives were established by the Farm Credit Act of 1933 as a financing vehicle for farmers with the long-term purpose that they would finance themselves. The intent of Congress was to stimulate a privately financed program, but temporary public financing was needed at the outset to get the system into successful operation. The Farm Credit Act of 1955 provided for three distinct classes of stock—A, B, and C. Class C stock was involved in that case and could be obtained under four circumstances:

(1) initial qualifying share
(2) quarterly stock purchases
(3) patronage refunds
(4) allocated surplus credit

The only circumstance involved there was number 2. The Court did not consider patronage refunds. In footnote 10, the Court referred to them as distributions of earnings eventually convertible to cash. In footnote 11, the Court indicated that it was not reviewing the contention that the patronage dividends should have been reported as income. This is very clear from the lower court's opinion, reported at 431 F. 2d 1320 (5th Cir. 1970), wherein it is stated at page 1322:

> * * * In the district court the government also contended that taxpayers should have reported the Class C stock received as patronage refunds as income. The court did not sustain this position and it has been abandoned by the government. As a result the present appeal is concerned solely with the tax treatment of the Class C stock purchased under the "interest override" requirements of 12 U.S.C. § 1134d(a)(3). [Footnotes omitted.]

The Court considered that there was virtually no market for the C shares but that the stock was intentionally given its characteristics by Congress with definite reason. Congress wanted the Banks to repay the capital extended by the Government and to retain private capital and this would not be facilitated if borrowers could redeem their stock for cash upon paying off their loans. The restrictions on the stock would provide a stable membership and permanent capital. The amount paid for C shares in quarterly purchases becomes part of the permanent capital structure of the Bank. The Court states at page 311: "The stock has value because it is the foundation of the cooperative scheme; it insures stability and continuity."

Two points should be considered: (1) the Court never considered a capital versus non-capital argument and never even mentions *Corn Products* but only considered the deducted versus capitalized argument, and (2) the Court kept talking about long-term value, foundation, and stability. Since the Court did not consider the argument presented in *Corn Products* and since it does not even mention that case, it is unreasonable to say that the Court has overruled it or even that it refutes it. Secondly, the stock involved in *Agway* does not provide a foundation and stability for United. On the contrary, it is intended that the patronage dividend stock be redeemed when the capital is considered adequate. This is in the by-laws.

Concerning Congressional intent, in *Mississippi Chemical* there was the intent of Congress to make the Banks for Cooperatives self-sustaining and to make the Class C stock part of the permanent capital structure. In order for a Bank to lend money, it had to have a continuing supply of capital. This was brought about by purchases of Class C stock. However, in *Agway* there is no similar Congressional intent. There is no Congressional involvement with United other than the establishment of tax-exempt status under § 521 of the Code. There is no need for the patronage dividends to be part of the permanent capital structure. In fact, according to Article 7, section 14, of United's by-laws, capital advances would be retired when United's capital was adequate in the judgment of the board of directors.

Therefore, it would seem that, rather than *Mississippi Chemical*, *Corn Products* and prior cases of this court applying the Corn Products doctrine, *Waterman, Largen & Co.* v. *United States*, 189 Ct. Cl. 364, 419 F. 2d 845 (1969), *cert. denied*, 400 U.S. 869 (1970); *FS Services, Inc.* v. *United States*, 188 Ct. Cl. 874, 413 F. 2d 548 (1969); *Booth Newspapers, Inc.* v. *United States*, 157 Ct. Cl. 886, 303 F. 2d 916 (1962), should apply to *Agway*.

If, as the majority states, by applying the Corn Products doctrine "we would be effectively holding that cooperatives and their patrons could not hold capital stock as a capital asset," then so be it. If the type of stock is in nature a temporary capital advance, then, ipso facto, there is no investment intent in holding that stock since it is known and intended that it will be redeemed within a short period of time.

For the above reasons, I would allow defendant's motion for summary judgment, deny plaintiff's motion for summary judgment, and dismiss plaintiff's petition.

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**524 F. 2d 1206**

# COASTAL PETROLEUM COMPANY v. THE UNITED STATES

[No. 309-72. Decided October 22, 1975]

### ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

**Eminent domain; taking; just compensation; navigation servitude; project in aid of navigation and flood control.**—Plaintiff claims a compensable interest in limestone in the water bottoms lying within the boundaries of Lake Okeechobee premised upon a drilling lease entered into in 1944 between plaintiff and the Trustees of the Internal Improvement Fund of the State of Florida. For purposes of defendant's motion for summary judgment, plaintiff is conceded to be the lessee of a valid mineral-drilling lease. In 1965 the United States acquired from the Central and Southern Florida Flood Control District two easements covering at least part of the same land covered by plaintiff's lease, for purposes of constructing levees on Lake Okeechobee. Plaintiff alleges that in building and maintaining the levee, the United States prevented plaintiff from mining limestone under and near the levee and that the United States mined and used limestone from the bed of the lake belonging to plaintiff, all of which amounted to a Fifth Amendment taking of its property—

both the right to mine and the minerals themselves. It is *held* that the project is entitled to the benefits of the navigation servitude and that the United States can use the limestone as part of its exercise of the servitude without compensation to plaintiff; this applies both to the limestone under and near the levee and to the limestone found below ordinary high water within the navigable waters so long as it was employed for the levee project. Defendant's motion for summary judgment is granted as to Count 1 of the petition. Since Count II of the petition which is not now before the court asserts a separate claim under another lease for the taking of limestone in another part of Florida in the course of building the Trans-Florida Canal, the case is remanded to the trial division for appropriate proceedings.

**Judgments; former adjudications; state courts, authority of decisions of.**

[1] Where the District Court of Appeals of Florida for the First District determined that the subject lease granted plaintiff drilling rights for all minerals defined in the broadest sense, and the Florida Supreme Court refused to review the decision, this court is bound by said decision on this issue. (*Stoner* v. *New York Life Ins. Co.*, 311 U.S. 464 (1940).)

Courts 🔑 93(1)

**Constitutional law; Congress, powers of; Commerce, regulation of—Art. I, sec. 8; navigable waters, rights of Government in.**

[2] The navigation servitude privilege reserves to the Federal Government a dominant interest in all submerged property within navigable waters below ordinary high water mark, and owners of property or property rights within such waters take those rights fully cognizant of their limited nature. The servitude covers the whole of the water found to be navigable, not merely the channel actually used.

Navigable Waters 🔑 36

**Constitutional law; Congress, powers of; Commerce, regulation of—Art. I, sec. 8; navigable waters, rights of Government in; flood control projects.**

[3] Whether the actions of the United States in connection with construction of a levee on Lake Okeechobee over which the Federal Government has continued to retain control were in aid of navigation or for flood control, the navigation servitude principle applies since the statute under which many flood control undertakings, including that in issue, are authorized states that the projects are for benefit of navigation and control of destructive floodwaters and other purposes.

Levees and Flood Control 🔑 1

**Eminent domain; just compensation; navigation servitude.**

[4] While Congress may decide in a particular case not to rely on navigation servitude, but rather to compensate owners of sub-

merged land in navigable waters for actions which, like those to which the servitude is applicable, are grounded in the power of the Federal Government to regulate commerce, where a project has a legitimate navigation purpose and there is no ascertainable congressional intent to pay compensation, the presumption is that Congress intended to exercise both its navigation power and the navigation servitude.

Navigable Waters ⚷ 2

**Eminent domain; taking; compensability; navigation servitude.**

[5] Where the court has determined that the navigation servitude applies to the subject Lake Okeechobee project, plaintiff's right to mine limestone at the lake bottom under and near the levee was subservient to the use of the property by the Federal Government in aid of navigation, and defendant could, without compensation, preempt use of the lake bottom to support the levee rather than allow it to be used for mining.

Navigable Waters ⚷ 36(4)

**Pleading and practice; summary judgment; generally.**

[6] On summary judgment, the court must read the facts in a light most favorable to the party against whom judgment is sought.

Courts ⚷ 470

**Constitutional law; Congress, powers of; Commerce, regulation of—Art. I, sec. 8; scope of Federal power over navigation.**

[7] The power of the Federal Government over navigation covers the total project; when the Corps of Engineers decided (if it did) to use the limestone for the levee project—which was itself covered by the navigation servitude—the use of submerged minerals below ordinary high water mark of the same navigable water was authorized as part of and directly incident to the main work, and no payment had to be made to plaintiff. That the United States might have received some commercial, rather than military, benefit from the use of the limestone does not reduce the extent of the dominant interest.

Navigable Waters ⚷ 36(4)

*Irving R. M. Panzer*, attorney of record, and *E. Michael Paturis*, for plaintiff. *C. Dean Reasoner* and *Reasoner, Davis & Vinson*, of counsel.

*Irwin L. Schroeder*, with whom was *Assistant Attorney General Wallace H. Johnson*, for defendant.

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Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

DAVIS, *Judge*, delivered the opinion of the court:

This is a tussle over some limestone at the bottom of Lake

Okeechobee in Florida. Plaintiff Coastal Petroleum Company, claiming a compensable interest in the limestone through a lease from an organ of the State of Florida, says that the United States took the mineral without paying for it. The defendant, for its part, asserts, first, that plaintiff has no such compensable interest, and, second, that in any event the Federal Government had the right to use the limestone under its navigation servitude which it exercised in the Lake Okeechobee project. Defendant has moved for summary judgment on this portion of the petition.[1]

For the purposes of this motion, plaintiff is conceded to be the lessee of a valid mineral-drilling lease, granted by the Trustees of the Internal Improvement Fund of the State of Florida, originally let in 1944, modified in 1947 and renewable for five-year terms.[2] This document, Drilling Lease No. 248, grants plaintiff "[a]ll those water bottoms lying within the boundaries of Lake Okeechobee * * * for the purpose of drilling for and producing therefrom oil, gas, sulphur, casinghead gas and casinghead gasoline * * *." Florida has held this lease to cover all minerals.[3]

In 1965, the United States acquired from the Central and Southern Florida Flood Control District two easements covering at least part of the same land covered by the Coastal lease, for the purpose of "construction, maintenance and operation" of the levees on Lake Okeechobee authorized by the Act of June 30, 1948, ch. 771, § 203, 62 Stat. 1176.[4] The easements granted the United States by the Flood Control District had previously been conveyed to the District by Coastal's lessor, the Florida Internal Improvement Fund, in order to pass them on to the United States. The easements specifically allowed the United States to "dig, excavate or otherwise construct artificial channels or waterways" and to "erect or construct levees and/or dikes."[5]

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[1] Count II of the petition asserts a separate claim under another lease for the taking of limestone in another part of Florida, in the course of the building of the Trans-Florida Canal. That count is not now before us.

[2] There is now pending in the Fifth Circuit a case challenging on state grounds the existence and validity (after 1964) of plaintiff's leases from the Internal Improvement Fund. The Fifth Circuit has referred the issue to the Supreme Court of Florida. *See infra.* The United States reserves the right to attack the lease on that state ground if its present motion is denied.

[3] In a 1960 decision as to which certiorari was discharged by the Florida Supreme Court, 125 So. 2d 300, the District Court of Appeals of Florida for the First District determined that the lease included drilling rights for all minerals defined in the broadest sense. *Collins* v. *Coastal Petroleum Co.*, 118 So. 2d 796, 803 (Fla. Dist. Ct. App. 1960). As a decision on the point by an intermediate state court, which the highest court refused to review, this ruling is binding on us, *Stoner* v. *New York Life Ins. Co.*, 311 U.S. 464, 467 (1940), and we assume that Coastal's drilling rights included the right to mine limestone.

[4] The authorizing statute is short and does not contain a description of the project. However, it incorporates by reference the *Comprehensive Report on Central and Southern Florida for Flood Control and Other Purposes, H.R.*

In the middle or late 1960's, the Corps of Engineers commenced construction of the levee on Lake Okeechobee. It was built "by digging a borrow pit and placing the excavated material on the lake side of the borrow pit." Affidavit of C. W. Pritchett, dated April 14, 1975. In 1968 Coastal filed a suit in the U.S. District Court for the Southern District of Florida in which the company attempted to obtain a mandatory injunction requiring the Corps to issue Coastal a permit to mine limestone in the lake. The permit had been denied because state and local authorities, who were joined as defendants, refused to support the application, largely for environmental reasons. Coastal asked in the alternative for a decree on behalf of either the federal or state defendants condemning its property in either the lease or the minerals and granting compensation. In addition, Coastal asked compensation, against any defendant, for a taking of limestone mined by the Corps and used for the levee. The District Court refused on public policy grounds to grant the injunction, but found that the refusal to grant a permit had worked a taking by the state agencies and that Coastal was entitled to lost profits. *Coastal Petroleum Co.* v. *Secretary of the Army*, 315 F. Supp. 845, 850 (S.D. Fla. 1970). The court did not decide

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*Doc. No.* 643, 80th Cong., 2d Sess. (1948), which described the program in some detail, and includes plans for "a low levee * * * around the lake shore from the St. Lucie Canal northward to tie in with the present north shore levee." *Ibid.* at 40. The construction of that levee precipitated this suit.

[5] The easement provided that the Government did not acquire any right or interest "in and to any such spoil and spoil materials as may be excavated, dredged or otherwise removed from the hereinafter described lands, except for such excavated materials required for the Project Works hereinabove referred to * * *." The reason for this provision is unclear (it may have been designed to keep the United States from having to dispose of the spoil material), and the parties have not provided us with any information on the intent of either the Government or the Flood Control District. Both parties seem to agree, though, that the limestone is not "spoil" or "spoil material." In that event, the easement says nothing about title to it, although the existence of the proviso suggests that the United States was granted some rights to use materials found in the easement area.

whether there had also been a taking by the federal defendants, because the issue was at that time before the Fifth Circuit in another case. In July, 1970, the Fifth Circuit decided in *Zabel* v. *Tabb*, 430 F. 2d 199 (5th Cir. 1970), *cert. denied*, 401 U.S. 910 (1971), that a refusal by the Corps of Engineers to grant a permit (there, to fill a bay) because the project would have adverse environmental, rather than navigation, effects, was a proper exercise of federal power under the Commerce Clause and, additionally, because of the navigation servitude, did not work a taking of any property rights of the owners of the bed of the bay and land riparian to it. *Ibid.* at 214, 215.

Reacting to *Zabel*, the District Court on October 6, 1970. reversed its earlier decision on the taking issue, and declared that "the federal defendants had the right to deny plaintiff's application to mine in the 5.7 acres applied for, and therefore there was no taking of plaintiff's property in the 5.7 acres." Order, Nos. 68-951-Civ-CA and 69-699-Civ-CA (S.D. Fla. Oct. 6, 1970). The court asked for further briefs on whether the federal defendants should be dismissed or the case transferred to the Court of Claims, evidently on the view that the District Court did not have jurisdiction to declare an inverse condemnation of plaintiff's property if the amount exceeded $10,000. *See* 28 U.S.C. § 1346 (a)(2). In a memorandum decision and order dated February 5, 1971, the District Court dismissed the suit as against the federal defendants, and found that, as a matter of state law, Coastal had acquired by its lease no compensable property right to the minerals in Lake Okeechobee prior to the time they were mined, and that therefore the state defendants were not liable to Coastal for any taking by virtue of their having granted the United States the easement to build the levee. Coastal did not appeal either the decision dismissing as against the federal defendants or the determination that its ownership rights under the leases were limited to minerals already mined. The state defendants appealed the court's separate holding that Coastal's lease was currently valid under Florida law.

Following the District Court decision, however, Coastal filed suit in this court alleging that in building and maintaining the levee, the United States (1) prevented Coastal from mining limestone under and near the levee and (2) mined and used limestone from the bed of Lake Okeechobee, which limestone belonged to Coastal, all of which amounted to a Fifth Amendment taking of plaintiff's property—both the right to mine and the minerals themselves. Because the Fifth Circuit, as a result of the appeal by the state defendants in the District Court case, has before it the issue of the validity of Coastal's leases from 1964 to the present (including the period during which the levee was built), proceedings in this case were stayed awaiting decision on that issue. The Fifth Circuit has certified the question to the Florida Supreme Court, which appears unlikely to respond in the near future.

Defendant now contends, in its motion for summary judgment, that the case can be disposed of in its favor, without considering the validity of the lease under state law, on either of two grounds—that Coastal is collaterally estopped from asserting its ownership of unmined minerals by the unappealed decision in the District Court case or that any "taking" is non-compensable by reason of the navigation servitude. Coastal replies that, since the federal defendants were dismissed from the District Court suit for lack of jurisdiction, the doctrine of mutuality prevents the Government from now relying on the decision with respect to the scope of the lease in favor of the state defendants in that case. Coastal also says that the Lake Okeechobee project was a flood control project, rather than an action in aid of navigation, that Congress recognized this, and that therefore the navigation servitude does not apply.

We need not now consider whether plaintiff is collaterally estopped by the District Court's ruling that under Florida law the lease gives it no compensable interest in the limestone in place because we are satisfied that, in any event, the United States can use that limestone, as it has, as part of the exercise of its navigation servitude.

The latter privilege reserves to the Federal Government a dominant interest in all submerged property within navigable waters, below mean ordinary high water mark. *United States* v. *Chicago, M., St. P. & P. R.R.*, 312 U.S. 592, 596–97

(1941). This navigation servitude is an extremely old concept—owners of property or property rights within navigable waters take those rights fully cognizant of their limited nature. *United States* v. *Kansas City Life Ins. Co.*, 339 U.S. 799, 808 (1950); *Gibson* v. *United States*, 166 U.S. 269 (1897). Plaintiff has admitted in answer to defendant's interrogatories that all the minerals about which it complains (in this part of its petition) were located below ordinary high water. Answers of Coastal Petroleum Co. to Interrogatories of Defendant ¶10. Coastal attempts, however, to take the case outside the navigation servitude by pointing out, as one of its points, that the limestone may not all have been taken "from the navigable waterway of the United States that runs through Lake Okeechobee." *Ibid.* The short answer to this contention is that "[t]he navigation easement is not limited to the thread of the stream where vessels pass, but extends from ordinary high water on one side to ordinary high water on the other." *Allen Gun Club* v. *United States*, 180 Ct. Cl. 423, 429 (1967). Where applicable, the servitude covers the whole of the water found to be navigable, not merely the channel actually used.

The main argument for plaintiff is that the right of the United States to take or use such submerged property is limited to actions in aid of navigation, but that the work here was for flood control, rather than to aid navigation. The categories are not so distinct. In *Allen Gun Club* v. *United States*, *supra*, we held that flood control projects on the Mississippi and its source streams were also, because of the disastrous effects flooding has on navigation, projects in aid of navigation and that the navigation servitude therefore applied. 180 Ct. Cl. at 429–30; *see United States* v. *Twin City Power Co.*, 350 U.S. 222, 223–24 (1956); *United States* v. *Grand River Dam Authority*, 363 U.S. 229, 231–33 (1960); *United States* v. *Commodore Park, Inc.*, 324 U.S. 386, 391–93 (1945); *cf. Oklahoma ex rel. Phillips* v. *Guy F. Atkinson Co.*, 313 U.S. 508, 525–26 (1941). The statute under which many flood control undertakings, including the Central and Southern Florida Flood Control Project, are authorized states that the projects are "for the benefit of navigation and the control of destructive floodwaters and other purposes." Act of June 30, 1948, ch. 771, § 203, 62 Stat. 1175. Such a declaration has consistently been held conclusive to determine the navigation purpose of a project. *United States* v. *Grand River Dam Authority*, *supra* at 232, and cases cited therein; *United States* v. *Twin City Power Co.*, *supra* at 224, and cases cited. Furthermore, the particular action which forms the basis of this suit, the construction of the Lake Okeechobee levee, was included in the project in large part because of the benefits it would provide for navigation on the Intracoastal Waterway, and this was one of the few parts of the project over which the Federal Government retained control after construction. H.R. Doc. No. 643, 80th Cong., 2d Sess. 8, 36–37, 41, 49, 53 (1949). We hold, therefore, that the project involved here is entitled to the benefits of the navigation servitude.

Congress may, of course, decide in a particular case not to rely on the servitude, but rather to compensate owners of submerged land in navigable waters for actions which, like those to which the servitude is applicable, are grounded in the power of the Federal Government to regulate commerce. *United States* v. *Gerlach Live Stock Co.*, 339 U.S. 725, 739 (1950); *F.P.C.* v. *Niagara Mohawk Power Corp.*, 347 U.S. 239, 254–56 (1954). But where a project has a legitimate navigation purpose, and there is no ascertainable Congressional intent to pay compensation, the presumption is that Congress intended to exercise both its navigation power and the navigation servitude. *United States* v. *Twin City Power Co.*, *supra*, 350 U.S. at 225; *United States* v. *Kansas City Life Ins. Co.*, *supra*, 339 U.S. at 808 (decided the same day as *Gerlach*); *United States* v. *Rands*, 389 U.S. 121, 122–24 (1967). That presumption is strengthened here by the proviso in the statute authorizing the project that "nothing herein shall impair or abridge the powers now existing in the Department of War with respect to navigable streams * * *" Act of June 22, 1936, ch. 688, § 3, 49 Stat. 1571; *see* Act of June 30, 1948, ch. 771, § 201, 62 Stat. 1175. We find nothing to persuade that Congress, despite its traditional right to use the submerged property without compensation, desired to make payment to the owners.

To say the navigation servitude applies to the Lake Okeechobee project needs, however, to be further refined. Coastal makes two distinguishable claims—one relating to its inability to mine under and near the levee and the other concerning the use of limestone mined by the United States in building the levee. Once we have determined that the navigation servitude applies to this project, it is obvious that Coastal need not be compensated for loss of its right to take the stone under and near the levee. Such mining would in all probability have destroyed the levee either directly or by weakening the subsurface structure. Since any right to mine was subservient to the use of the property by the Federal Government in aid of navigation, the Corps of Engineers could, without compensation, preempt use of the lake bottom to support the levee rather than allow it to be used for mining.

While the application of the navigation servitude to limestone mined by the Government elsewhere than in the borrow pit for use in the levee is less clear,[6] we believe that the principle of *United States* v. *Commodore Park, Inc.*, 324 U.S. 386 (1945), requires a decision for defendant. In that case, the United States, to provide better landing facilities for sea planes based at the Hampton Roads Naval Operating Base, dredged Willoughby Bay, a navigable waterway, to a depth of 10 to 15 feet below mean low water. The dredged material was used to enlarge the shore facilities of the Base by placement at the mouth of Mason Creek, thereby destroying the navigability of that water. *Ibid.* at 389. Commodore Park owned fastlands on Mason Creek, and sued for a taking of that part of the value of its land which was based on its fronting on a navigable waterway. *Ibid.* at 387–88. The District Court found that neither the dredging nor the filling of Mason Creek had any relation to navigation, and granted compensation. The Fourth Circuit Court of Appeals affirmed, holding that while the dredging was related to navigation, the fill, which had caused the damage, was not. *Ibid.* at 388, 391. The Supreme Court reversed on two main grounds.

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[6] Defendant's position is murky as to whether limestone from outside the borrow pit was used in constructing the levee. In its answer to Coastal's petition, defendant appeared to admit that substantial quantities of limestone from the lake bed were used in the construction. Answer ¶9; *see* Answer to First Amended Petition ¶9. On the other hand, in its latest submission, the affidavit of Construction Branch Chief C. W. Pritchett, defendant seems to imply that the only limestone taken from the lake bed was taken when the borrow pit, because of the irregularity of the lake shore, entered the lake. Affidavit of C. W. Pritchett ¶¶4, 5; Note 1 to Map entitled Levee 47–Section 1, Plan and Sections, submitted with affidavit. If this later explanation is correct, the servitude would clearly bar recovery since the borrow pit was an integral part of the levee and water control system. However, given the requirement that we view the facts most favorably to plaintiff on defendant's motion for summary judgment, *United States* v. *Diebold, Inc.*, 369 U.S. 654, 655 (1962), and the uncertainty of defendant's response, we have considered the case on the assumption that limestone was quarried from the middle of the lake, outside of the immediate construction area.

First, the Court found that there was no property interest owned by Commodore Park in the flow of Mason Creek, a finding which is irrelevant to this case as we now decide it. The Court then went on to find that the filling of Mason Creek was covered by the navigation servitude even though it impeded, rather than aided, navigation, and even though the project was on a distinct, though connected, body of water from the Bay where dredging in aid of navigation occurred. *Ibid.* at 392–93. It was the total project, not individual pieces of it which Congress, through the War Department, had determined to be in aid of navigation—and that judgment, invoking the navigation servitude, was not to be disturbed. *Ibid.* at 392.

We think the same reasoning is applicable here. The Lake Okeechobee project must be considered as authorized as a whole, for construction as found proper by the Corps of Engineers. When the Corps decided (if it did, *see* note 6 *supra*) to use limestone found below ordinary high water within the navigable waters in order to build the levee, there was "not an invasion of any private property right in such lands for which the United States must make compensation. The damage sustained resulted not from a taking of the * * * owner's property in the stream bed, but from the lawful exercise of a power to which that property has always been subject." *United States* v. *Chicago, M., St. P. & P. R.R.*, *supra*, 312 U.S. at 597. So long as the limestone was employed for the levee project—which was itself plainly covered by the navigation servitude—that use of submerged minerals below the high water mark of the very same navigable water was authorized as part of and directly incident to the main work. No payment had to be made. "[T]he Congress, and those to whom it has delegated authority, may, without Fifth Amendment liability, employ land submerged under navigable water in the way that in their best judgment helps to accomplish the overall purpose even if, intentionally or not, they impair navigation for some purposes in some areas." *Allen Gun Club* v. *United States*, *supra*, 180 Ct. Cl. at 430. That the United States might have received some commercial, rather than military (as in *Commodore Park*, *supra*), benefit from use of the limestone does not reduce the extent of the dominant interest. *See United States* v. *Rands*, *supra; United States* v. *Twin City Power Co.*, *supra.*

The defendant's motion for summary judgment is granted [7] and Count I of the petition is dismissed. The case is remanded to the trial division for appropriate proceedings on Count II.

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524 F. 2d 729

## GEORGE ZUCKMAN AND ETHEL ZUCKMAN v. THE UNITED STATES

[No. 798-71. Decided October 22, 1975]

### ON PLAINTIFFS' AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Taxes; income tax; classification of organization for tax purposes; limited partnership.**—Plaintiff seeks an income tax refund, plus interest, for calendar year 1968 on the theory that the organization of which he was a member was a limited partnership so that operating losses suffered by the partnership passed through to the individual partners on a pro rata basis. Plaintiff's loss deductions were disallowed by the Internal Revenue Service for the stated reason that the organization during the applicable period was considered an association taxable as a corporation. Plaintiff paid the full amount of the proposed assessment, plus statutory interest, filed a timely claim for refund, and not having had action on his claim, filed suit in this court. Plaintiff was a limited partner (owning 1% and .546%, respectively, before and after construction) in a real estate project known as Towne House, formed as a limited partnership under Missouri law, whose stated purpose was to acquire a specific parcel of real property in St. Louis, Missouri and to construct and operate an apartment building thereon. Forest Park (FP), a corporation and the sole general partner of Towne House (owning 51% and 69.577% before and after construction), was the wholly-owned subsidiary of Kanter Corporation which, in turn, was wholly owned by J. H. Kanter (K), one of the three original limited partners (owning 46% and 29.331%, respectively, before and after construction). The third limited partner owned the same percentage interest as plaintiff. Mr. Kanter held a continuing proxy from Kanter Corp. to vote all of the stock of (FP) "as though he owned the stock in his individual capacity." Construction of the apartment building was financed by a loan insured by the Federal Housing Administration pursuant to an FHA Regulatory Agreement, executed by Towne House and incorporated by amendment into the limited partnership agreement, which prohibited voluntary dissolution of Towne House absent FHA approval during the period the property was subject to the FHA mortgage. Applying Treas. Reg. § 301.7701-2 et seq. relating to the classification of organizations for tax purposes, the Uniform Limited Partnership Act and applicable Missouri law, it is *held* that Towne House more nearly resembled a partnership for tax purposes than a corporation during the period in question, and that plaintiff was entitled to deduct his distributive share of the Towne House losses for calendar year 1968. Plaintiff's motion for summary judgment is granted, defendant's cross-motion is denied, and judgment is entered for plaintiff for $6,299.56 plus interest as provided by law.

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[7] Plaintiff has challenged the appropriateness of summary judgment, contending that there should be a trial to ascertain the purposes and scope of the Lake Okeechobee project, as well as of the circumstances surrounding the Government's use of the limestone. We think, however, that there is ample basis for our determination in the affidavit and documents supplied by the parties and in the legal materials relating to the project of which we can properly take judicial notice. Plaintiff does not present enough to raise any factual issue which should be tried.

**Taxes; income tax; partnerships; limited partnership v. corporation; corporate characteristics.**

[1] Under Treas. Reg. § 301.7701-3(b) an organization qualifying as a limited partnership under state law may be classified for tax purposes as an association if, after the standards in the regulation dealing with associations are considered, the limited partnership more closely resembles a corporation than a partnership. An association will be classified as a corporation, rather than a partnership, if it has associates, an objective to carry on business and divide the gains therefrom, continuity of life, centralization of management, liability for corporate debts limited to corporate property and free transferability of interests. Since the first two characteristics are common to both partnerships and corporations, they are generally disregarded in distinguishing between the two.

**Internal Revenue 🔑 831**

**Taxes; income tax; partnerships; classification as partnership.**

[2] Generally, if an organization is found to lack two or more of the four major corporate characteristics, i.e., continuity of life,

centralization of management, limited liability and free transferability of interests, it will be classified for tax purposes as a partnership rather than as an association.

Internal Revenue ⚷ 831

**Taxes; income tax; partnerships; limited partnership; continuity of life.**

[3] A limited partnership subject to a state Uniform Limited Partnership Act-type statute cannot have the corporate characteristic of continuity of life, even if the partnership agreement provides for continuation of the business by the remaining partners in the event of a member's death or withdrawal, where local law provides that retirement, death or insanity of a general partner dissolves the organization. The mere reservation in the limited partnership agreement of a power in the remaining partners to continue the business on a general partner's withdrawal, constitutes only a contingent continuity of existence, insufficient to satisfy the continuity of life standard of Treas. Reg. § 301.7701-2(a)(1).

Internal Revenue ⚷ 831

**Taxes; income tax; partnerships; limited partnership; continuity of life; FHA loan agreement.**

[4] Treas. Reg. § 301.7701-2(b)(3) distinguishes between a general partner's *right* and his *power* under local law to dissolve the partnership entity. Since the general partner had the power under Missouri law to dissolve the partnership, the organization lacked the corporate characteristic of continuity of life, notwithstanding an FHA loan amendment to the limited partnership agreement prohibiting the partnership's voluntary dissolution or bankruptcy while its property was subject to an FHA insured mortgage.

Internal Revenue ⚷ 831

**Taxes; income tax; partnerships; limited partnership; centralization of management; substantial interest test.**

[5] If the limited partners own substantially all the partnership's interests, the general partner can only be acting on their behalf, i.e., in a representative capacity, and under Treas. Reg. § 301.7701-2(d)(4) the partnership must possess the corporate characteristic of centralized management. However, where a limited partner's *de facto* control of the sole general partner afforded him the dominant interest in the organization, this in itself does not constitute corporate centralized management. Absent statutory provision, application by the court of a constructive ownership rule to the determination of the locus of substantial ownership and control in a limited partnership precludes a finding that the partnership possessed centralized management.

Internal Revenue ⚷ 831

**Taxes; Treasury Regulations; validity of regulation; classification of organization for tax purposes.**

[6] Treas. Reg. §§ 301.7701-1, -2, and -3, relating to classification of

an organization for income tax purposes, are reasonable, conform to the revenue statute, and are, therefore, valid.

Internal Revenue 🔑 831

**Taxes; income tax; partnerships; corporation v. limited partnership; centralization of management; substantial interest test.**

[7] The substantial interest test of Treas. Reg. § 301.7701-2(d)(4) applicable to limited partnerships is only a shorthand means of ascertaining, in the ordinary case, whether or not the centralized management power is held and exercised in a representative capacity, i.e., by directors acting on behalf of the stockholders.

Internal Revenue 🔑 831

**Taxes; income tax; partnerships; limited partnership; limited liability.**

[8] Treas. Reg. § 301.7701-2(d)(1) provides that an organization has the corporate characteristic of limited liability, if there is no member who is personally liable for the debts of and claims against the organization under local law, and further provides that personal liability exists with respect to a general partner where, *inter alia*, the general partner has no substantial assets and is not merely a "dummy" acting as the agent of the limited partners. Where the sole general partner (FP) has no assets and is under the *de facto* control of a limited partner (K), the limited partnership cannot have the corporate characteristic of limited liability, since (FP) is personally liable if it is not a "dummy," the limited partners for whom (FP) acts as agent are personally liable if (FP) *is* a "dummy" and, accordingly, at least one of the partnership's "members"—either general or limited—must at all times bear personal liability.

Internal Revenue 🔑 831

**Taxes; income tax; partnerships; limited partnership; free transferability of interests; "substantially all" interest.**

[9] A 61% interest does not constitute "substantially all" within the meaning of Treas. Reg. § 301.7701-2(e)(1).

Internal Revenue 🔑 831

**Taxes; income tax; partnerships; limited partnership; free transferability of interests.**

[10] Where (K), the limited partner holding a majority interest in the subject organization, indirectly owned the general partner (FP) and held a continuing proxy to vote all of (FP's) stock, the requirement of consent by (FP) to any assignment of (K's) partnership interest was a matter of form; therefore, (K's) interest was in effect freely transferable within the meaning of Treas. Reg. § 301.7701-2(e)(1). However, since the Uniform Limited Partnership Act as adopted in Missouri provides that a sole general partner's assignment of his interest and substitution of another for himself without the consent of the limited partners results in the partnership's technical dissolution unless the right to continue the business is specifically accorded the substituted general partner by the lim-

ited partnership certificate, and since the subject partnership certificate provided that "no right is given the general partner or the limited partners to continue the business on the retirement * * * of the general partner," the general partner's interests were not freely transferable. Accordingly, the limited partnership lacked the corporate characteristic of free transferability of interests.

Internal Revenue ⚿ 831

**Taxes; income tax; partnerships; limited partnership; corporate characteristics.**

[11] Since Treas. Reg. § 301.7701-2(a)(3) provides that if an organization has more corporate characteristics than noncorporate characteristics it will be classified as an association, and since the regulation specifically covers only four "major" corporate characteristics which are not common to both partnerships and corporations, the court interprets the test to mean that, as a general rule, any partnership *lacking two or more* of these characteristics will not be classified as an association; conversely, any partnership *having three or more* will be classified as an association.

Internal Revenue ⚿ 831

*Bart A. Brown, Jr.*, attorney of record, for plaintiffs. *David S. Mann* and *Dismore, Shohl, Coates & Deupree*, of counsel.

*John E. Evans*, with whom was *Assistant Attorney General Scott P. Crampton*, for defendant. *Robert H. McKnight, Jr.*, and *Theodore D. Peyser*, of counsel.

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, and SKELTON, *Judge*.

COWEN, *Chief Judge*, delivered the opinion of the court: This case concerns the proper classification for tax purposes of a limited partnership with a sole corporate general partner pursuant to Treasury Regulations Section 301.7701-2.[1] Plaintiff, George Zuckman, joined by his wife, Ethel Zuckman,[2] seeks a refund of $6,299.56 plus interest for Feeral income taxes paid for the calendar year 1968.

During 1968, plaintiff held an interest, as limited partner, in a Missouri real estate development group known as Towne

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[1] All references hereinafter to regulations are to Treasury Regulations.

[2] Ethel Zuckman is a party to this action solely as a consequence of her having filed a joint income tax return with her husband. The term "plaintiff" hereinafter refers only to George Zuckman.

House. The principal issue presented by the parties' respective motions for summary judgment is whether Towne House should be classified as an association or a partnership. If classified as an association, which is taxable as a corporation under Section 7701(a)(3) of the Internal Revenue Code of 1954,[3] then only the association itself may take deductions for any net operating losses sustained during its 1968 taxable year. Section 11(a). If classified as a partnership within the meaning of Section 7701(a)(2) of the Code, then plaintiff may deduct his pro rata share of such losses under Section 701, which permits the pass-through of partnership income and losses to the individual partners. Since we find that Towne House, under the standards set forth in Treasury Regulations Section 301.7701-2, "more nearly resemble[d]" a partnership than a corporation during the period in question, we conclude that plaintiff was entitled to deduct his distributive share of the Towne House losses. Accordingly, we grant plaintiff's motion for summary judgment, and deny defendant's cross motion.

The parties are generally in agreement as to the material facts. The stated purpose of Towne House, formed as a limited partnership under Missouri law by an agreement dated June 10, 1964, was to acquire a specific parcel of real property in St. Louis, Missouri, known as the Lindell property, and to construct and operate an apartment building on that property. The original partners of Towne House and their respective interests before and after completion of construction were as follows:

| *Partner* | *Interest Before Construction (percent)* | *Interest After Construction (percent)* |
|---|---|---|
| Forest Park of Missouri, Inc | 51 | 69.577 |
| J. H. Kanter | 47 | 29.331 |
| Robert Blatt | 1 | .546 |
| Plaintiff George Zuckman | 1 | .546 |

The limited partnership agreement designated Forest Park as the sole general partner, and J. H. Kanter, Mr. Blatt, and the plaintiff as limited partners.

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[3] All statutory section references are to the Internal Revenue Code of 1954 unless otherwise noted. All such references in the opinion refer to applicable provisions in force in 1968.

Forest Park, incorporated under Missouri law on July 17, 1963, was the wholly-owned subsidiary of Kanter Corporation, which in turn was wholly owned by J. H. Kanter. During the period in question, Kanter Corporation had net assets in excess of $3,500,000. From the time of Towne House's formation on June 10, 1964, through the taxable year ending March 31, 1968, Forest Park remained capitalized at only $500, had no substantial assets other than its interest in Towne House, and engaged in no activities beyond those directly related to Towne House. On August 7, 1963, J. H. Kanter, as president and sole shareholder of Kanter Corporation, received from the directors of that corporation a continuing proxy to vote all of the stock of Forest Park "as though he owned the stock in his individual capacity." By use of this proxy, J. H. Kanter elected all of the Forest Park directors during the period in suit. Three of Forest Park's five officers and directors served concurrently as officers and full-time employees of Kanter Corporation. None of these latter officers received any compensation from Forest Park during the fiscal year 1968.

In October 1963, Forest Park acquired the Lindell property from Millstone Construction, Inc., for $574,500, payable pursuant to a promissory note executed jointly by Forest Park and Kanter Corporation. Shortly thereafter, Kanter Corporation pledged all of its Forest Park stock to Millstone Construction as security for the promissory note. A principal payment of $424,500 was made on the note in July 1967, and a new note for $150,000 was executed by Forest Park and Kanter Corporation.

Construction of the apartment building was financed by a loan of $7,873,300 from the Central Trust Company to Towne House. The loan was evidenced by a Deed of Trust Note dated June 24, 1964, secured by the deed of trust executed that same date by Towne House, and insured by the Federal Housing Administration pursuant to Towne House's execution of an FHA Regulatory Agreement. This latter agreement, in part, prohibited voluntary dissolution of Towne House absent FHA approval, so long as the Towne House property remained subject to the FHA insured mortgage.[4]

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[4] The FHA prohibition was incorporated into the Towne House Limited Partnership Agreement by amendment dated June 24, 1964.

The agreement further provided that none of the partners of Towne House would be personally liable for repayment of the FHA loan. Towne House defaulted on its mortgage payments in 1967 and, on September 27, 1967, an agreement restoring the mortgage to current status was executed among Towne House, the FHA, and Kanter Corporation, whereunder Kanter Corporation assumed a potential liability to the FHA of $78,333.

Plaintiff and Mr. Blatt were the largest shareholders and highest officers of Towne Construction, Inc., which was incorporated in Missouri on June 4, 1964, to serve as general contractor for the Towne House construction project. In the contract between Towne Construction and Towne House, dated June 22, 1964, Towne House reserved the right to approve all subcontracts. Beginning in June 1964, Kanter Corporation rendered services to Towne Construction for which it was paid $53,000.

Additional limited partners were added at various times during 1967 and 1968. These new partners were all subcontractors on the Towne House construction project. Thereafter, the partners and their respective interests for the taxable year ending March 31, 1968, were as follows:

| *Partner* | *Interest (percent)* |
|---|---|
| Forest Park | 61. 829 |
| J. H. Kanter | 21. 798 |
| Robert Blatt | 1. 014 |
| Plaintiff | 1. 014 |
| Burroughs Glass Co. | . 355 |
| Metal Trims, Inc. | . 811 |
| Ray R. Dolan, Sr. | . 253 |
| Daniel F. Shedran | . 253 |
| Milton J. Ortbal | . 169 |
| Stephen Gorman Bricklaying Co., Inc. | 6. 759 |
| Thomas J. Dolan | 1. 690 |
| Daniel E. Siegel | 4. 055 |
| | 100. 000 |

For its fiscal year ending March 31, 1968, Towne House had a net operating loss of $1,050,759. In computing this loss, Towne House took deductions for depreciation in the amount of $533,302 and for interest in the amount of $426,333. As of March 31, 1968, plaintiff had contributed a total of $7,500 to

Towne House as a limited partner. Plaintiff's distributive share of Towne House's loss for the fiscal year ending March 31, 1968, was $10,655. This loss was claimed by plaintiff on his Federal income tax return for calendar year 1968. By letter dated January 12, 1970, the District Director of Internal Revenue, Cincinnati, Ohio, issued a proposed assessment, disallowing plaintiff's claimed deductions for the stated reason that Towne House, during the applicable period, was to be considered an association, and not a partnership, for tax purposes. On November 30, 1970, plaintiff paid the full amount of the proposed assessment, plus statutory interest, and on December 14, 1970, filed a timely claim for refund. After more than six months had elapsed without action on the claim, plaintiff instituted this suit.

## I

### *The Classification Regulations*

The Internal Revenue Code defines a partnership to include "a syndicate, group, pool, joint venture, or other unincorporated organization * * * which is not, within the meaning of this title a trust or estate or a corporation." Section 7701(a)(2). A corporation is defined to include "associations, joint-stock companies, and insurance companies." Section 7701(a)(3). To clarify and effectuate these rather broadly drawn definitions, the Internal Revenue Service promulgated a series of regulations embodying standards for each of the three major classes of business organizations—associations (taxable as corporations), partnerships and trusts. Reg. §§ 301.7701-2 (1960) (associations), -3 (partnerships), and -4 (trusts).

The regulation applicable to partnerships states that an organization qualifying as a limited partnership under state law may be classified for tax purposes as an association if, after the standards in the regulation dealing with associations are considered, the limited partnership more closely resembles a corporation than a partnership. Reg. § 301.7701-3 (b). The regulation dealing with associations articulates six corporate characteristics: (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests. Reg. § 301.7701-2(a)(1). Since (1) associates and (2) an objective to carry on a business and divide the gain are characteristics common to both partnerships and corporations, they are generally disregarded in distinguishing between the two. Reg. § 301.7701-2(a)(2). Thus, the classification of a limited partnership with a corporate general partner as either a partnership or a corporation for income tax purposes must turn on the remaining four characteristics.

The regulations in their present form are the product of a long and turbulent evolution in the application of the income tax laws to various types of organizations.[5] The corporate characteristics applied for purposes of tax classification were first enumerated by the Supreme Court in the 1935 landmark case of *Morrissey* v. *Commissioner*, 296 U.S. 344 (1935). *Morrissey* involved a trust created for the development of a golf course and the sale and rental of attached real estate. The trustees were accorded broad management and control rights, liability was limited to the trust property, beneficial interests were freely transferable and the death of a trustee did not terminate the trust. In holding the trust taxable as an association, the Court set out the six characteristics of a corporation, stating that if an organization more closely resembled a corporation than another type of business organization, then it should be classified as one and taxed accordingly. 296 U.S. at 360.

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[5] Review of this evolution, particularly as it reflects the continuing conflict between the Internal Revenue Service on the one hand, and professional groups seeking association status and real estate syndicates seeking partnership status on the other, suggests why the current regulations appear so heavily weighted in favor of partnership classification. *See* Rustigan, *Effect of Regulation Definitions on Real Estate Syndicates*, N.Y.U. 19th Inst. on Fed. Tax. 1065 (1961). *See also* Comment. *Tax Classification of the Limited Partnership with a Sole Corporate General Partner under the Regulations and Revenue Procedure 72–13*, 20 Wayne L. Rev. 135 (1973); Stein, *Partnership Taxation for the Limited Partnership with a Corporate General Partner—It Can Be Done*, 25 U. Miami L. Rev. 435 (1971); Allison, *The Limited Partnership with a Corporate General Partner—Federal Taxation—Partnership or Association?* 24 Sw. L. J. 285 (1970).

Expanding the scope of this principle beyond the area of trusts, the Court noted: "The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity. The resemblance points to the features distinguishing associations from partnerships as well as from ordinary trusts." 296 U.S. at 357. This rule became known as the "resemblance test," and regulations embodying the test were promulgated under the Internal Revenue Code of 1939.[6]

A second stage in the development of the classification regulations occurred during the two decades following the *Morrissey* decision, as increased personal tax rates encouraged many professional groups to create associations and file corporate tax returns. The Internal Revenue Service opposed this movement and in 1954, another landmark case, *United States* v. *Kintner*, 216 F. 2d 418 (9th Cir. 1954), was decided. In *Kintner*, the Ninth Circuit affirmed the trial court's finding that a group of doctors who were operating a clinic under "articles of association" should be taxed as a corporation under the *Morrissey* standards.

Subsequently, in order to make it more difficult for an unincorporated association to meet the standards of corporate resemblance, the Service issued new regulations. These "Kintner Regulations" were issued under the Internal Revenue Code of 1954 and appeared in 1960. Reg. § 301.7701-1 to -11, T.D. 6503, 1960-2 Cum. Bull. 412. In addition to specifically directing the courts to look to state law in order to determine whether or not a particular corporate characteristic existed, Reg. § 301.7701-1(c), a regulation required that "more corporate characteristics than noncorporate characteristics" be present before an organization could be classified as an association. Reg. § 301.7701-2(a)(3).[7] The regulations set forth each of the four distinguishing corporate characteristics in detail.

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[6] Reg. 103, § 19.3797-1 to -7 (1939); Reg. 111, § 29.3797-1 to -7 (1943); Reg. 118, § 39.3797-1 to -7 (1953).

[7] This numerical test is discussed in Part VI of this opinion. For present purposes, it is sufficient to note, as a general rule, that if an organization is found to lack two or more of the four "major" corporate characteristics, it will be classified for tax purposes as a partnership rather than as an association.

## II

### *Continuity of Life*

The first of the four corporate characteristics, continuity of life, is defined by the regulation to exist when "the death, insanity, bankruptcy, retirement, resignation, or expulsion of any member will not cause a dissolution" of the organization. Reg. § 301.7701–2(b)(1). As a shorthand route to this determination, the final sentence of the regulation—added as part of the 1960 amendments—provides, in blanket fashion, that "a general partnership subject to a statute corresponding to the Uniform Partnership Act and a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act both lack continuity of life." Reg. § 301.7701–2(b)(3). The State of Missouri has adopted without material change both the Uniform Partnership Act (hereinafter referred to as the "UPA") and the Uniform Limited Partnership Act (hereinafter referred to as the "ULPA"). *See City of North Kansas City, Missouri* v. *Sharp*, 414 F. 2d 359, 366 (8th Cir. 1969); 6 U.L.A. 65 (Supp. 1975). In addition, there is no dispute that Towne House was formed as a limited partnership pursuant to the Missouri statute. Accordingly, were the regulation to be literally applied, a finding that Towne House lacked the corporate characteristic of continuity of life would be inescapable.

Defendant argues, however, that two factors in this case present a unique circumstance not provided for by either the regulation or the ULPA: (1) the existence of a sole corporate general partner, and (2) an amendment to the limited partnership agreement, executed pursuant to a separate FHA underwriting agreement, expressly prohibiting the partnership's voluntary dissolution. By virtue of these two factors, defendant contends, literal application of the regulation's shorthand test would be inappropriate, inasmuch as the remainder of the regulation dictates inquiry into the substance, not merely the form, of a particular entity. We disagree with defendant and hold, in express accordance with the regulation, that a limited partnership subject to a ULPA-type statute cannot have the corporate characteristic of continuity of life.

Even had the last sentence of the regulation been omitted, however, the same result would necessarily follow under the detailed standards set forth in the remainder of the regulation.[8] The regulation provides that:

> If the retirement, death, or insanity of a general partner of a limited partnership causes a dissolution of the partnership, unless the remaining general partners agree to continue the partnership or unless all remaining members agree to continue the partnership, continuity of life does not exist.

Reg. § 301.7701-2(b)(1). The regulation further states that, even if the partnership agreement provides for continuation of the business by the remaining partners in the event of a member's death or withdrawal, such agreement will not establish continuity of life "if, under local law, the death or withdrawal of any member causes a dissolution of the organization." Reg. § 301.7701-2(b)(2).

Looking first to local law, Section 20 of the ULPA (Mo. Ann. Stat. § 359.200) articulates the causes of dissolution as follows:

> The retirement, death or insanity of a general partner dissolves the partnership, unless the business is continued by the remaining general partners
>
> (1) Under a right so to do stated in the Certificate; or
>
> (2) With the consent of all members.

Under its Limited Partnership Agreement of June 10, 1964, Towne House was to continue in existence until the year 2010 unless sooner terminated in accordance with the agreement's other terms. Paragraphs (14) and (15) of the Agreement provide for such earlier termination under the following circumstances:

> (b) *Managing Partner*. In the event of the adjudication of bankruptcy or the forfeiture of the corporate charter

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[8] Since identical results are reached both under the regulations' standards and under what we have termed its "shorthand" test, which incorporates applicable provisions of the ULPA, it is reasonable to infer that the detailed standards will generally be unnecessary when dealing with an entity formed under a ULPA-type statute. When the current regulations first appeared, in 1939, without the final sentence, only 20 jurisdictions had then adopted the ULPA. *See* 6 U.L.A. 65 (Supp. 1975). By 1960, however, when the final sentence appeared, only 12 jurisdictions had not yet adopted the Act and, hence, this greater uniformity among state partnership laws permitted use of an abbreviated test.

> of the Managing Partner, the Partnership shall be dissolved.
>
> 15. *Causes of Dissolution of Partnership.* The Partnership shall be dissolved upon the happening of any of the following events:
>
> (a) The adjudication of bankruptcy, or the forfeiture of the Charter of the Managing Partner.
>
> (b) The decision of Partners owning a majority of the participation units then owned by all Partners to dissolve the Partnership.

Thus, even were we to find that Forest Park, the sole corporate general partner, were subject to the complete control of J. H. Kanter, making its voluntary withdrawal unlikely, it could still become bankrupt and, in such event, Towne House's dissolution would automatically result. *See* 11 U.S.C. § 23 (when all general partners are adjudged bankrupt, so is the partnership).

Nor, for several reasons, could dissolution be avoided by means of a right to continue the business. First, such right is unequivocally eliminated by paragraph (13) of the Towne House Certificate of Limited Partnership, which states that:

> Under the partnership agreement no right is given to the general partner or the limited partners to continue the business on the retirement, or disability or forfeiture of charter of the general partner.

Second, since the withdrawal of Forest Park would leave no remaining general partners exclusively entitled under the ULPA to continue the business, there could be no continuation in any event. Finally, under the rule announced in *Glensder Textile Co.* v. *Commissioner*, 46 B.T.A. 176, 185–86 (1942), expressly adopted by the Treasury in its final regulations, Reg. § 301.7701-2(b)(1), the mere reservation in the limited partnership agreement of a power in the remaining general partners to continue the business on a general partner's withdrawal, constitutes only a "contingent continuity of existence," insufficient to satisfy the regulation's corporate standard.

Notwithstanding the above, defendant argues that the amendment to the Towne House Limited Partnership Agreement (hereinafter referred to as the "FHA amendment"), in consideration for which the FHA undertook to insure a non-recourse loan to Towne House of nearly $8,000,000, is controlling here. The amendment provides, in pertinent part, that:

> * * * 2. There is added to section 15b the following provision. There shall be no voluntary dissolution of the partnership so long as the property of the partnership is subject to an FHA insured mortgage without the express prior written approval of the Commissioner of the Federal Housing Administration.

Defendant also cites the Regulatory Agreement itself, which states that:

> Owners shall not file any petition in bankruptcy, or for a receiver, or in insolvency, or for reorganization or composition, or make any assignment for the benefit of creditors or to a trustee for creditors; or permit an adjudication in bankruptcy, the taking possession of the mortgaged property or any part thereof by a receiver, or the seizure and sale of the mortgaged property or any part thereof under judicial process or pursuant to any power of sale and fail to have such adverse actions set aside within 45 days.

Defendant contends that the effect of these agreements was to deprive the owners of Towne House of their right lawfully to dissolve the partnership and, hence, that Towne House thereby contractually assumed the corporate characteristic of continuous existence.

We agree with defendant that by the FHA amendment, Forest Park relinquished its right voluntarily to withdraw from Towne House, or otherwise to act, or fail to act, in such a way as to cause dissolution of the partnership under Missouri law. In this respect, the FHA amendment was little different in effect from a provision in a partnership agreement that the firm is to be continued for a definite term, or until accomplishment of a particular undertaking. Under such circumstances, it has long been held in Missouri, as elsewhere, that no partner has the right to dissolve the partnership until the term has ended or the undertaking been accomplished. *See, e.g.*, *Zimmerman* v. *Harding*, 227 U.S. 489 (1913); *Pemberton* v. *Ladue Realty and Construction Co.*, 237 Mo. App. 971, 180 S.W. 2d 766 (1944); *Fuller* v. *Laws*, 219 Mo. App. 342, 271 S.W. 836 (1925); *Seufert* v. *Gille*, 230 Mo. 453, 131 S.W. 102 (1910).

It does not follow, however, as defendant further contends, that because Forest Park surrendered its *right* to voluntarily dissolve the Towne House partnership, it also and simultaneously surrendered its *power* to do so. The Treasury Regulation, the Uniform Acts and the weight of relevant decisions are to the contrary. They consistently distinguish between a partner's right and his power to dissolve the partnership entity, notwithstanding the existence of an agreed term or transaction to be completed. As the regulation states:

> In determining whether any member has the *power* of dissolution, it will be necessary to examine the agreement and to ascertain the effect of such agreement under local law * * * [I]f the agreement provides that the organization is to continue for a stated period or until the completion of a stated transaction, the organization has continuity of life if the effect of the agreement is that no member has the *power* to dissolve the organization in contravention of the agreement. Nevertheless, if, notwithstanding such agreement, any member has the *power* under local law to dissolve the organization, the organization lacks continuity of life.

Reg. § 301.7701-2(b)(3) [Emphasis added].

The significance of this distinction was well expressed in the early case of *Karrick* v. *Hannaman*, 168 U.S. 328, 334–37 (1897), where the Supreme Court, addressing the question of whether one partner, without the assent of the other, has the power to dissolve a partnership for a specified term before the expiration thereof, stated as follows:

> A contract of partnership is * * * in effect, a contract of mutual agency, each partner acting as a principal in his own behalf and as agent for his copartner. [Citation omitted.] No partnership can efficiently or beneficially carry on its business without the mutual confidence and cooperation of all the partners. Even when, by the partnership articles, they have covenanted with each other that the partnership shall continue for a certain period, the partnership may be dissolved at any time, at the will of any partner, so far as to put an end to the partnership relation and to the authority of each partner to act for all; but rendering the partner who breaks his covenant liable to an action at law for damages, as in other cases of breaches of contract. [Citations omitted.] [T]he only difference, so far as concerns the right of dissolution by one partner, between a partnership for an

> indefinite period and one for a specified term, is this: In the former case, the dissolution is no breach of the partnership agreement, and affords the other partner no ground for complaint. In the latter case, such a dissolution before the expiration of the time stipulated is a breach of the agreement, and as such to be compensated in damages. But in either case the action of one partner does actually dissolve the partnership.

*See also* Restatement, Second, *Agency* § 118.

This recognition in *Karrick* of a partner's power to dissolve, although the right to dissolve does not exist, has been followed by a majority of American jurisdictions, *see* Crane & Bromberg on Partnership § 75, at 427–28 (1968), and has been incorporated in the Uniform Partnership Act,[9] Sections 31(2) and 38(2)(a)(II).

In sum, whether Forest Park had the right, voluntarily or involuntarily, to cause dissolution of the partnership, *i.e.*, could do so without breaching the partnership agreement and incurring liability therefore, is immaterial.[10] Since Forest Park had the power under Missouri law to dissolve the partnership, irrespective of the consequences, we conclude that—even absent the final unequivocal sentence of the regulation, Reg. § 301.7701-2(b)(3)—Towne House lacked the corporate characteristic of continuity of life.

## III

### *Centralization of Management*

The second corporate characteristic, centralization of management, is defined by the regulation as "a concentration of continuing exclusive authority to make independent business decisions on behalf of the organization which do not require ratification by members of such organization." Reg. § 301.7701-2(c)(3). As with continuity of life, the final sentences of the regulation, added in 1960, ostensibly furnish a shorthand test for application to limited partnerships "subject to a statute corresponding to the Uniform Limited Partnership Act." Reg. § 301.7701-2(c)(4). Such partnerships, the regulation states, "*generally* do not have centralized management, but centralized management *ordinarily* does exist in such a limited partnership if substantially all the interests in the partnership are owned by the limited partners." *Id.* [Emphasis added].

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[9] Section 6(2) of the Uniform Partnership Act makes the UPA applicable to limited partnerships except insofar as it is inconsistent with the Uniform Limited Partnership Act.

[10] It may be noted, however, that although the consequences of wrongful or premature termination are disregarded for purposes of the Treasury Regulations, both the UPA and ULPA contain ample provisions for the protection of the partnership's remaining partners, creditors and adverse claimants. Thus, we see no merit in defendant's tacit suggestion that Forest Park's withdrawal and dissolution of Towne House would leave the FHA and other creditors and obligees without recourse on their claims. Under the Uniform Act, as adopted in Missouri, "on dissolution, the partnership is not terminated but continues until the winding up of partnership affairs is completed." UPA § 30 (Mo. Ann. Stat. § 358.300). Further, the dissolution of a partnership, whether limited or general, does not abrogate existing contracts to which it is a party. *See City of North Kansas City, Missouri* v. *Sharp*, 414 F. 2d 359,

As the words "generally" and "ordinarily" imply, limited partnership status does not in itself preclude centralized management, as it does continuity of life. Unlike a general partnership, wherein the mutual agency relationship between partners empowers each partner to act on behalf of the entity and to bind all partners by his acts, notwithstanding any agreement vesting management in a selected few, limited partners typically lack virtually all management control rights. Thus, insofar as "continuing exclusive authority to make independent business decisions" is concentrated in the hands of the general partners, a limited partnership may be said always to possess centralized management.

This was essentially the position adopted by the Treasury in its proposed regulations, issued in December 1959. 24 Fed. Reg. 10450. In response to these, substantial objections were raised on the ground that the regulation had long observed a distinction between centralized management in the corporate sense and the limited partnership sense, respectively.[11] In the corporate context, there could be no centralized management unless the management power is held and exercised in a representative capacity, *i.e.*, by directors, acting as representatives of the stockholders. In the limited partnership context, however, centralized management meant that the

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366 (8th Cir. 1969) (applying Missouri law); *Prater* v. *Rush*, 228 Mo. App. 922, 74 S.W. 2d 875 (1934); *Armstrong* v. *Henley*, 182 Mo. App. 320, 170 S.W. 402 (1914).

[11] *See* Rustigan, *Effect of Regulation Definitions on Real Estate Syndicates*, N.Y.U. 19th Inst. on Fed. Tax 1065, 1071 (1965).

general partner has the exclusive management power, ULPA § 9, and acts primarily in his own behalf, subject only to the fiduciary duty he owes to the other partners. UPA §§ 18–23. Association status for tax purposes under the regulations turns upon an organization's resemblance to a corporation. Reg. § 301.7701–2(a)(1). The focus of inquiry must therefore be on the "representative," rather than the "centralized," character of management, inasmuch as centralization *per se* is generally common to both corporations and limited partnerships and, hence, immaterial in distinguishing between the two. Reg. § 301.7701–2(a)(2).

The characteristic of centralized management held in a representative capacity was recognized as a corporate trait in the *Morrissey* decision from which the present regulations derive, 296 U.S. at 359, and was incorporated into the definitional sentence of the regulation, which states: "Centralized management means a concentration of continuing exclusive authority to make independent business decisions *on behalf* of the organization * * *." Reg. § 301.7701–2(c)(3) [Emphasis added]. The final regulation, promulgated in 1960, bears out this continuing focus on the representative character of an organization by providing that centralized management will ordinarily obtain in a limited partnership "if substantially all the interests in the partnership are owned by the limited partners." Reg. § 301.7701–2(c)(4). The rationale for this ownership test, as suggested by the foregoing analysis, is that if the limited partners own substantially all the partnership's interests, then the general partner can only be acting on their behalf, *i.e.*, in a representative capacity, and, hence, the partnership must possess the corporate management characteristic.

In applying this test, defendant contends that, since J. H. Kanter indirectly owned and controlled Forest Park, "it is entirely appropriate for present purposes to consider Forest Park's ownership interest in Towne House as in substance owned by J. H. Kanter." *Defendant's Brief*, at p. 85. By means of such attribution, defendant's argument runs, J. H. Kanter should be considered the owner of 98 percent of the interests in Towne House (Forest Park's 51 percent plus J. H. Kanter's 47 percent) up to the time of the admission of additional limited partners (*i.e.*, to at least December 15, 1967), and the owner of 83 percent thereafter. Accordingly, Towne House must possess the corporate characteristic of centralized management since, under the regulation, "substantially all the interests in the partnership are held by the limited partners" (*i.e.*, J. H. Kanter). This argument is adroit but unacceptable.

First, we can find no authority, nor has any been cited by defendant, for applying a constructive ownership rule to the determination of the locus of substantial ownership and control in a limited partnership. Certainly no such rule can expressly be found among the pertinent statutes and regulations. Experience likewise suggests that where such a rule has been considered appropriate, defendant has proven adept at making such appropriateness known other than by resort to mere inference and analogy. *See, e.g.*, Int. Rev. Code §§ 267, 318, 544 and 554. In arguing for the applicability of a constructive ownership rule, defendant is in effect challenging its own regulation. It is well settled, however, that "Treasury regulations must be sustained unless unreasonable and plainly inconsistent with the revenue statutes." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501 (1948); *see United States* v. *Correll*, 389 U.S. 299, 305–06 (1967); *Birchenough* v. *United States*, 187 Ct. Cl. 702, 710, 410 F. 2d 1247, 1252 (1969); *Weyerhaeuser Co.* v. *United States*, 184 Ct. Cl. 492, 497, 395 F. 2d 1005, 1008 (1968).

In a recent case, moreover, we expressly held that the instant regulations "are reasonable, conform to the revenue statutes and are, therefore, valid." *Outlaw* v. *United States*, 204 Ct. Cl. 152, 169, 494 F. 2d 1376, 1386 (1974), *cert. denied*, 419 U.S. 844 (1974). Under these circumstances, the regulations must be considered as binding on the Government as they are on the taxpayer. *See Weyerhaeuser Co.* v. *United States*, *supra; McCord* v. *Granger*, 201 F. 2d 103, 106 (3d Cir. 1952). The express language of the regulation neither directly nor otherwise contemplates application of a constructive ownership rule. Absent such a rule, Forest Park's undoubtedly substantial interest in Towne House's capital and profits would ordinarily preclude a finding that the latter possessed centralized management.

Even were Forest Park's interest attributable to J. H. Kanter on some theory, the result—under our reading of the regulation—would be the same. Centralized management, taken in the abstract, is common to both corporations and limited partnerships. The regulation's ownership (or "substantial interest") test applicable to limited partnerships is only a shorthand means of ascertaining, in the ordinary case, whether or not the centralized management power is held and exercised in a representative capacity, *i.e.*, by directors acting on behalf of the stockholders. Where substantially all the interests in an organization are owned by the limited partners, *i.e.*, distributed broadly among a comparatively large number of limited partners *qua* stockholders, then the regulation erects a presumption that the centralized management power (in the hands of the general partner or partners) will generally be exercised on the limited partners' behalf. Were Forest Park's interest attributable to J. H. Kanter, however, as defendant contends, J. H. Kanter's resultant 98 percent (or 83 percent) interest in Towne House would in itself effectively rule out any possibility of representative management.

## IV

### *Limited Liability*

The regulation states that an organization has the third corporate characteristic, limited liability, if there is no member[12] who is personally liable for the debts of and claims against the organization under local law. Reg. § 301.7701–2 (d)(1). Personal liability is defined as existing when a creditor or tort victim may seek personal satisfaction from a member of the organization to the extent that the assets of the organization are insufficient to satisfy his claim. *Id.* In this case, these are essentially two members as to whom personal liability may exist for the debts of and claims against Towne House: Forest Park and J. H. Kanter.

Defendant argues that personal liability cannot exist as to Forest Park since, under the regulation, it has no substantial assets (other than its interest in the partnership) which could be reached by a creditor of Towne House, and is merely a "dummy" acting as the agent of the limited partners (*i.e.*, J. H. Kanter). Plaintiff, while conceding that Forest Park had no substantial assets, counters that determination of the corporate partner's "dummy" status involves questions of fact which, if critical to the outcome, would be inappropriate for resolution on this motion for summary judgment.

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[12] Under the regulation, to establish that Towne House lacks the corporate characteristic of limited liability, plaintiff need only show that any of its *members, i.e.*, Forest Park or J. H. Kanter, could be held personally answerable for the partnership's debts.

With respect to J. H. Kanter, the second party as to whom personal liability may exist for Towne House's debts, the parties reach a similar impasse. Both agree, and plaintiff vigorously supports the fact, that "beyond question J. H. Kantner completely ran the Towne House show," *Plaintiff's Reply Brief*, at pp. 13–19; *Defendant's Reply Brief*, at p. 18, and that he "was the single person in charge of all of Towne House's business decisions," *Plaintiff's Brief*, at p. 5; *Defendant's Brief*, at p. 87. Plaintiff argues, however, that these facts alone, insofar as they establish that J. H. Kanter was in "control" of Towne House, are sufficient to make J. H. Kanter personally liable for the partnership's debts. In support of this contention, plaintiff relies on Section 7 of the Uniform Limited Partnership Act (Mo. Ann. Stat. § 359.070) and Missouri decisions construing it. Section 7 states that:

> A limited partner shall not become liable as a general partner unless, in addition to the exercise of his rights and powers as a limited partner, *he takes part in the control of the business.*

[Emphasis added]. Plaintiff also relies on the applicable portion of the regulation, which provides that:

> Notwithstanding the formation of the organization as a limited partnership, when the limited partners act as the principals of such general partner, personal liability will exist with respect to such limited partners.

Reg. § 301.7701-2(d)(2).

Defendant, relying on the same statute and regulation and generally identical decisions, counters that J. H. Kanter's control of the business, although conceded, is not in itself sufficient to make him a general partner in fact, or otherwise to render him personally liable for Towne House's obligations. For personal liability to exist, according to defendant, plaintiff must show not only that J. H. Kanter was in control of Towne House but, in addition, that his words or actions have actually and reasonably led third parties to believe that he was generally liable, and to act on that belief. *Defendant's Brief*, at p. 87; *Defendant's Reply Brief*, at pp. 20–21. Such requisite third party reliance, defendant contends, simply cannot be shown in this case, inasmuch as "J. H. Kanter at all times was held out as only a limited partner." *Brief*, at p. 87.

Clearly if, as plaintiff contends, the fact of "control" alone constitutes a sufficient basis in law for holding J. H. Kanter personally liable, then we must conclude that Towne House lacks the corporate characteristic of limited liability. If, however, as defendant argues, third party reliance constitutes a necessary and material factor in the limited liability equation, we are presented, as in the case of Forest Park's disputed "dummy" and agency status, with a genuine issue of material fact inappropriate for resolution on these cross motions for summary judgment.

However, we have concluded that it is unnecessary to remand either of these factual issues for trial in order to determine that Towne House lacks the corporate characteristic of limited liability, inasmuch as the regulation itself, albeit none too lucidly, mandates such a finding as a matter of law.

The portion of the regulation dealing with limited liability, added *in toto* as part of the 1960 amendments, incorporates by reference applicable provisions of the ULPA as a shorthand test similar to those tests, earlier discussed, bearing upon centralized management and continuity of life. As the history of the 1960 amendments suggests, the intent of the drafters was to make it as difficult as possible for the then-burgeoning medical and legal partnerships to achieve association status for tax purposes. In this aim, particularly with respect to the characteristic of limited liability, the drafters were eminently successful.

Paragraph 2(d), subparagraph (1) of the regulation provides, in pertinent part, that:

> * * * [I]n the case of a limited partnership subject to a statute corresponding to the Uniform Limited Partnership Act, personal liability exists with respect to each

> general partner, except as provided in subparagraph (2) of this paragraph.

After stating the general rule that a limited partnership does not normally possess limited liability, subparagraph (2) merely describes four specialized situations to which this general rule will nonetheless apply, one situation to which it will not, and one in which personal liability will exist with respect to limited partners. Thus, subparagraph (2) states that personal liability will exist with respect to a general partner where (1) such general partner is a corporation having substantial assets which can be reached by creditors; (2) the general partner contributes only services, but still has substantial assets; (3) the general partner has substantial assets, although insufficient to satisfy the obligations of an organization engaged in large-scale financial transactions; and (4) the general partner has no substantial assets and is not merely a "dummy" acting as the agent of the limited partners. Since Forest Park, the sole general partner of Towne House, concededly has no substantial assets, we are concerned here only with (4). Thus, if Forest Park is *not* a "dummy," it is personally liable.

In only one situation does the regulation provide an exception to the general rule of personal liability with respect to the general partners of a limited partnership. If the general partner has no substantial assets (as here), and *is* merely a "dummy" acting as the agent of the limited partners, it is not personally liable. However, in that situation, the following provision of subparagraph (2), previously quoted above, becomes pertinent: "Notwithstanding the formation of the organization as a limited partnership, when the limited partners act as the principals of such general partner, personal liability will exist with respect to such limited partners." Thus, although the general partner is not personally liable when it is a "dummy" and acts merely as an agent, the limited partners as principals of the general partner are personally liable. In short, the regulation draws a tight, albeit opaque, circle by declaring that where the general partner of a limited partnership has no assets, only two alternatives may follow: (1) if it is not a "dummy", then it is personally liable; or (2) if it *is* a "dummy", then the limited partners for whom it acts as agent and who in turn serve as its principal, are personally liable. In either case, the limited partnership cannot have limited liability, inasmuch as at least one of its "members"—whether general or limited—must at all times bear personal liability.[13]

In view of the foregoing, it is unnecessary to proceed further to determine whether third party reliance existed in this case. Such determination would have bearing only upon the question of which party, Forest Park or J. H. Kanter, must ultimately bear personal responsibility for Towne House's obligations. For tax classification purposes, it is sufficient to conclude that either one or the other would have to bear such responsibility. Accordingly, we hold that, under the applicable regulation, Towne House lacks the corporation characteristic of limited liability.

## V

### *Free Transferability of Interests*

The fourth and last major corporate characteristic, free transferability of interests, is defined by the regulation to exist with respect to an organization when "[e]ach of its members or those members owning substantially all of the interests in the organization have the power, without the consent of other members, to substitute for themselves in the same organization a person who is not a member of the organization * * * [and] to confer upon [their] * * * substitute all the attributes of [their] * * * interest in the organization." Reg. § 301.7701-2(e)(1). *See also* Reg. § 301.7701-3(b)(2), example (1) (limited partner who may transfer his entire interest only with unanimous consent of general partners will not have a freely transferable interest).

Also added as part of the 1960 amendments, this portion of the regulation is perhaps the simplest and most straightforward in operation and, accordingly, its application presents little difficulty. While the term "substantially all" is not defined in the regulation, we may fairly and reasonably conclude that the 61 percent (and, after the admission of new limited partners, 49 percent) interest held by Forest Park, taken alone, would be insufficient.[14] Accordingly, in order for Towne House to possess the corporate characteristic of free transferability, it is necessary to show that not only Forest Park's interest, but J. H. Kanter's interest as well, was freely transferable.

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[13] *See* 1 Rabkin & Johnson, *Federal Income, Gift & Estate Taxation* § 2.11 (1970 Supp.); Comment, *Tax Classification of the Limited Partnership with a Sole Corporate General Partner Under the Regulations and Revenue Procedure 72–13*, 20 Wayne L. Rev. 135, 149 (1973).

In determining, first, whether J. H. Kanter had the power, without the consent of other members of Towne House, to substitute for himself a non-member of the organization, we must look to the pertinent provisions of the ULPA as adopted in Missouri. Section 19, subsection (4) thereunder (Mo. Stat. Ann. § 359.190(4)) provides that an assignee shall have the right to become a substituted limited partner if (i) all the members consent thereto, or (ii) the limited partnership certificate empowers the assignor to transfer all his interest to a substituted limited partner. Paragraph (10) of the Towne House Limited Partnership Certificate provides that:

> A limited partner has the right under the Partnership Agreement to substitute an assignee as contributor in his place *with the prior consent of the general partner* and upon execution by the assignee of the Partnership Agreement.

[Emphasis added]. Similarly, the Towne House Limited Partnership Agreement provides that "[N]o * * * transferee of the interest of a Limited Partner shall become a substituted limited partner without first obtaining the written consent of Managing Partner, and executing a copy of the Partnership Agreement."

Plaintiff contends that since under the statute and partnership certificate, J. H. Kanter's interest could be fully assigned only with the consent of Forest Park, J. H. Kanter's interest was therefore not freely transferable within the meaning of the regulation.

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[14] Plaintiff points out that the term "substantially all," as used elsewhere in the Internal Revenue Code, has been defined to mean "all except a negligible minority interest." *Burnet* v. *Bank of Italy,* 46 F. 2d 629, 630 (9th Cir. 1931), *cert. denied,* 283 U.S. 846 (1931). In addition, the Internal Revenue Service has for certain ruling purposes used a 90% figure as the benchmark for determining what constitutes "substantially all." Rev. Proc. 66-34, 1966-2 Cum. Bull. 1232, 1233. These indicia are persuasive. For our purposes, however, it is sufficient to conclude—without adopting any affirmative quantitative test—that a 61 percent interest would *not* constitute "substantially all" within the meaning of the regulation.

Defendant counters that, inasmuch as J. H. Kanter indirectly owned Forest Park, and held a continuing proxy from the Kanter Corporation directors to vote all of Forest Park's stock, the requirement of consent by Forest Park to any assignment of J. H. Kanter's partnership interest was a matter of form, not substance; therefore, J. H. Kanter's interest must be considered as freely transferable. We agree with defendant's contention.

While J. H. Kanter's *de facto* control of Forest Park could not in itself constitute corporate centralized management, which as earlier discussed additionally requires that such control be exercised in a representative capacity, the consequence of such control is different with respect to the characteristic of free transferability. So long as a member has the power, *unconditional* as between that member and the remaining members, to fully substitute a non-member for himself in the organization, the existence of a mere formal or nominal condition will not prevent such member's interest from being freely transferable within the meaning of the regulation.

Defendant further maintains, by reason of J. H. Kanter's *de facto* control of Forest Park, that J. H. Kanter also had complete discretion to fully transfer the Towne House interests of Forest Park. Accordingly, defendant argues that, since the combined interests of J. H. Kanter and Forest Park constituted "substantially all" of Towne House's outstanding interests, Towne House must be deemed to have the corporate characteristic of free transferability. We disagree.

In the absence of an agreement to the contrary, a sole general partner of a limited partnership may assign his interest and substitute another for himself without the consent of the limited partners, but such assignment and substitution will result in a technical dissolution of the partnership unless the right to continue the business is specifically accorded the substituted general partner by the limited partnership certificate. ULPA § 9 (Mo. Ann. Stat. § 359.090). Paragraph (13) of the Towne House Certificate provides that:

> Under the partnership agreement no right is given the general partner or the limited partners to continue the business on the *retirement* or disability or forfeiture of charter of the general partner. [Emphasis added].

Thus, for a substitute general partner to have the power, without dissolution, to continue the business on the retirement or withdrawal of the original general partner, there must be unanimous ratification by the limited partners. As stated in Section 9 of the ULPA (Mo. Ann. Stat. § 359-090):

> A general partner shall have all the rights and powers and be subject to all the restrictions and liabilities of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to
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> * * * * *
>
> (7) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right to do so is given in the certificate.

Accordingly, since Forest Park's transfer of its Towne House interests and substitution of a new general partner in its place would require either the consent of all the limited partners (*i.e.*, not merely J. H. Kanter), or—absent such consent—would result in technical dissolution of the firm, Forest Park's interests are not freely transferable. As stated in the regulation:

> [A]lthough the agreement provides for the transfer of a member's interest, there is no power of substitution and no free transferability of interest if under local law a transfer of a member's interests results in the dissolution of the old organization and the formation of a new organization.

In sum, although J. H. Kanter's interests were, in effect, freely transferable within the meaning of the regulation, we find that Forest Park's interests were not. Hence, inasmuch as J. H. Kanter's interests alone could not constitute "substantially all" of the outstanding interests in the firm, we find that Towne House lacked the corporate characteristic of free transferability of interests.

## VI

### *Additional Characteristics*

Relying on the regulation and our recent decision in *Outlaw* v. *United States*, 204 Ct. Cl. 152, 169, 494 F. 2d 1376, 1385 (1974), *cert. denied*, 419 U.S. 844 (1974), defendant's final argument is that certain corporate characteristics other than those expressly identified and described in the regulations may be significant in determining whether an entity is a partnership or an association for tax purposes. The additional corporate characteristics as claimed by defendant are: (1) Forest Park had unilateral power to admit additional limited partners, and (2) Forest Park had exclusive discretion to determine when and if any of Towne House's available funds should be distributed to itself and the limited partners. *Brief*, at pp. 76–77; *Reply Brief*, at pp. 30–33. Inasmuch as we have already found that Towne House lacked all four of the "major" corporate characteristics expressly treated in the regulation, it is plainly unnecessary to consider additional ones in this case.

Moreover, it should be emphasized that our discussion herein of each of the four major corporate characteristics is in no way intended to suggest that an absence of all four characteristics must be found in order to hold a partnership taxable as such under the regulation. On the contrary, the regulation unequivocally states that if an organization "has more corporate characteristics than noncorporate characteristics," Reg. § 301.7701-2(a)(3), it will be classified as an association. Since the regulation specifically covers only four "major" corporate characteristics which are not common to both partnerships and corporations, we interpret the foregoing test to mean that, as a general rule, any partnership *lacking two or more* of these characteristics will not be classified as an association. Conversely, any partnership *having three or more* of these characteristics will be classified as an association.

This is not to say that a taxpayer claiming classification as a partnership will be entitled to prevail in every conceivable situation merely by showing that the organization lacks two of the four major corporate characteristics. As the regulation itself states:

> In addition to the major characteristics set forth in this subparagraph, other factors may be found *in some cases* which may be significant in classifying an organization as an association, a partnership, or a trust.
>
> * * * * *
>
> For example, if a limited partnership has centralized management and free transferability of interests but lacks continuity of life and limited liability, *and if the limited partnership has no other characteristics which are significant in determining its classification*, such limited partnership is not classified as an association.

Reg. § 301.7701-2(a) (1), (3) [Emphasis added].

But this is not such a case, nor can a contrary interpretation of this regulation be derived from our recent decision in *Outlaw*. At issue in *Outlaw* was whether a particular trust should be classified as a trust or a corporation for tax purposes. As such, the dispositive questions under the regulation were whether the trust had associates and an objective to carry on business and divide the gains therefrom. The remaining four major corporate characteristics—those addressed in the case presently before us—are treated by the regulation as common to both corporations and trusts and, hence, immaterial in distinguishing between the two. As the pertinent portion of the regulation states:

> Some of the major characteristics of a corporation are common to trusts and corporations, and others are common to partnerships and corporations. Characteristics common to trusts and corporations are not material in attempting to distinguish between a trust and an association, and characteristics common to partnerships and corporations are not material in attempting to distinguish between an association and a partnership. For example, since centralization of management, continuity of life, free transferability of interests, and limited liability are *generally common* to trusts and corporations, the deter-

> mination of whether a trust which has such characteristics is to be treated for tax purposes as a trust or as an association depends on whether there are associates and an objective to carry on business and divide the gains therefrom. On the other hand, since associates and an objective to carry on business and divide the gains therefrom are *generally common* to both corporations and partnerships, the determination of whether an organization which has such characteristics is to be treated for tax purposes as a partnership or as an association depends on whether there exists centralization of management, continuity of life, free transferability of interests, and limited liability.

As the term "generally" implies, the regulation clearly contemplates—as under its provision for consideration of "other factors"—that situations may arise where characteristics *generally* common to both corporations and partnerships, or corporations and trusts, may arguably be lacking in a particular case. Plaintiff has not argued, nor would it have been fruitful for him to argue, that the characteristics of associates and an objective to carry on business and divide the gains therefrom, are lacking in the instant case. Precisely because plaintiff in *Outlaw did* so argue, however (*i.e.*, against the regulation's presumption that the four partnership characteristics are generally common to trusts and corporations), it was necessary in that case to consider factors other than those which the regulation deems normally dispositive in distinguishing between corporations and trusts for tax purposes. Such a problem is not presented in this case.

## CONCLUSION

Since we find that Towne House should be classified as a partnership for tax purposes under Reg. § 301.7701–2, we conclude that plaintiff was entitled to deduct his distributive share of the Towne House losses for the calendar year 1968. Accordingly, it is ordered that plaintiff's motion for summary judgment is granted; defendant's cross motion for summary judgment is denied; and judgment is hereby entered in favor of plaintiff for the sum of $6,299.56, plus interest thereon as provided by law.

524 F. 2d 680

# ITT ARCTIC SERVICES, INC. v. THE UNITED STATES

[No. 324-73. Decided October 22, 1975]

## ON PLAINTIFF'S AND DEFENDANT'S MOTIONS FOR SUMMARY JUDGMENT

**Contracts; interpretation; Wage Escalation Clause; labor costs; foreign currency fluctuation; assumption of risk; contract reformation.**—Plaintiff contracted to provide operation and maintenance services under a series of successive management contracts with the United States Air Force on the Distant Early Warning Line (DEW Line). The present dispute involves only the Canadian portion of the DEW Line. The first contract was a cost-plus-fixed-fee contract, renewable annually, up to 1963; during fiscal years 1964–66 plaintiff operated under a fixed-price incentive-fee type contract; and following request for proposals for a multi-year contract, plaintiff was awarded a three-year firm fixed-price type contract effective July 1, 1969, with payment in U.S. dollars. These Contracts were subject to agreements between the United States and Canada providing that the U.S. contractor would give preference to Canadian labor, set and maintain wage rates and working conditions after consultation with and approval by the Canadian authorities, and pay Canadian labor in Canadian dollars. In May 1970 the Canadian Government unpegged the fixed American-Canadian currency exchange rate resulting in a rise in the value of the Canadian dollar over the U.S. dollar. Thus, plaintiff had to exchange more U.S. dollars in order to obtain sufficient Canadian currency with which to meet its required Canadian labor obligations. Plaintiff seeks to recover additional compensation for its increased costs resulting from said rise, contending that under the Wage Escalation clause of the contract such increased costs are compensable. The Armed Services Board of Contract Appeals decided that said clause did not afford price modification protection for the increased costs of floating Canadian currency. It is *held* that the contract language is directly in line with and protectively implementative of the parties' recognized contingency of action by the Canadian Government raising wage levels or benefits of plaintiff's Canadian labor, and correspondingly contrary and unimplementative of the parties' intent to include therein currency exchange rate fluctuation protection; that the labor costs referred to in the contract are only those under the direct control of the Canadian Government by virtue of the prior U.S.-Canadian agreement and do not include costs due to currency exchange rate fluctuations; that this interpretation is consistent with the ASPR requirement limiting price escalation in fixed-price contracts to "certain contingencies which are specially defined in the contract"; that plaintiff, despite the historic locus of the currency exchange rate fluctuation risk burden under its other DEW Line contracts, in accepting the subject firm fixed-price contract accepted the risk and responsibility for all costs under or over the firm fixed-price; that contract reformation is precluded; and that the Board's decision was correct. Defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and the petition is dismissed.

**Contracts; disputes; administrative decision; scope of review of Court of Claims.**

[1] Where plaintiff's motion for summary judgment makes general assertions of possible factual deficiencies in the decision of the Contract Appeals Board under review, absent plaintiff's specific supported demonstration of factual errors the Board's statement of facts will be accepted.

Courts ⚷ 470

**Contracts; interpretation; intention of parties to contract.**

[2] In the case of contracts, the avowed purpose and primary function of the court is the ascertainment of the intent of the parties. In attempting to give effect to such intent, the court is guided by the principles that the parties' intent must be gathered from the instrument as a whole preferably giving a reasonable meaning to all parts of the instrument rather than leaving a portion of it useless, from the perspective of a reasonably intelligent person acquainted with the contemporary circumstances, and ascribing to the contract language its ordinary and commonly accepted meaning without twisted or strained out-of-context analysis or without regard to the subjective unexpressed intent of one of the parties.

Contracts ⚷ 147(1)

**Contracts; interpretation; conduct of parties as aid to.**

[3] The parties to a contract are presumed to possess elementary commercial intelligence and to approach their undertaking with a reasonably clear understanding of the attendant complexities and consequences. Thus, where plaintiff entered into a firm fixed-price contract with the United States Air Force to perform operation and maintenance services, of which 90% of the costs were labor costs, in connection with the Canadian portion of the DEW Line program, and where plaintiff relinquished control over the various labor cost items to Canadian authorities pursuant to a United States-Canadian agreement and was thus subject to labor cost increases upon directive from the Canadian authorities, one would reasonably expect an exprienced contractor such as plaintiff to protect itself against the risks and consequences of unavoidable third-party increases in its labor costs.

United States ⚷ 70(23)

**Contracts; Wage Escalation clause; foreign currency fluctuation; labor cost increases.**

[4] The Wage Escalation clause in a firm fixed-price contract specifically excludes from labor cost increases entitling a contractor to a contract price modification "any general and administrative costs, overhead or profit." In doing business in a foreign country, the purchase of that country's currency to meet contractor's local obligations is an expense attributable to the overall operation of the concern, and not naturally or reasonably attributable alone to either the cost of labor or supplies. Rather the cost of currency ultimately expended for both of these items and other necessary elements of a business operation more reasonably must be classified as a general expense as the incurrence of the currency cost is of both general and necessary benefit to all phases of an international contractor's operations.

United States ⚷ 70(22)

**Contracts; assumption of risk.**

[5] In firm fixed-price contract situations, the payee party, absent a specific contrary contract provision, assumes the risk of currency valuation changes. While under plaintiff's prior fixed-price-incentive-fee contract, defendant bore the risk of currency exchange rate fluctuations, there is nothing osmotic in the shift of the risk of such fluctuations to plaintiff where there was a deliberate change from the prior type contract to a firm fixed-price contract not providing for foreign currency fluctuations, especially where the record does not suggest that the parties were unaware of the distinguishing characteristics of a firm fixed-price contract or that the measured progression through prior contract types was inadvertent.

United States ⚷ 70(22)

**Contracts; Armed Services Procurement Regulations; applicability.**

[6] The Armed Services Procurement Regulations are law binding on the parties in a Government contract and govern the interpretation of the contract.

United States ⚷ 70(4)

**Contracts; assumption of risk.**

[7] Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered. (*United States* v. *Spearin*, 248 U.S. 132 (1918).) Firm fixed-price contracting places maximum risk on the contractor for all costs over the fixed price including unanticipated costs.

United States ⚷ 70(20)

**Contracts; Wage Escalation clause; foreign currency fluctuation; labor cost increases.**

[8] Where a Wage Escalation clause was designed to protect plaintiff in performance of its multi-year, firm fixed-price contract with the United States Air Force to provide operation and maintenance

services in Canada on the DEW Line, from cost increases arising from actions of the Canadian Government raising pay rates and benefits over which the Canadian Government by contractual agreement with the United States exercised unrestricted, unilateral control, absent provision in the contract contemplating adjustment for foreign currency fluctuations the risk was on plaintiff for labor cost increases resulting from the higher cost of Canadian dollars, since the cost increases due to currency rate fluctuations resulting from the Canadian Government's action in unpegging the fixed American-Canadian currency exchange rate were not the type of cost increases the Canadian Government could unilaterally impose upon plaintiff under the United States-Canadian agreement. Furthermore, interpreting the clause to confine contract price modifications to labor cost increases and collateral benefits costs is consistent with the requirement of ASPR § 3.404–3 limiting price escalation in fixed-price contracts to "certain contingencies which are specifically defined in the contract."

United States ⚿ 70(22)

**Contracts; interpretation; ambiguity; generally.**

[9] The necessary precursor for resort to the rule of *contra proferentem* is the determination that a contract clause is ambiguous, i.e. susceptible of more than one reasonable interpretation, in which event the ambiguity will be construed against the author of the document. Contracts are not necessarily rendered ambiguous by the mere fact that the parties disagree as to their meaning. There must be a reasonable uncertainty of meaning.

Contracts ⚿ 143(2)

**Contracts; reformation; grounds for reformation.**

[10] For reformation of a firm fixed-price contract to afford relief from a contractor's higher labor costs due to Canadian currency rate fluctuations beyond the contractor's control, it is necessary to establish some antecedent expressions by the parties at variance with the terms of the contract or some articulated mutual assumption regarding the behavior of the Canadian exchange rates which the court could incorporate into the contract or some indication that a mutual mistake existed as to a hard fact on which the parties had based the contract. Absent such elements or an indication that defendant would have been willing if it had known the facts from the beginning to bear a substantial part of the increased labor costs, contract reformation is precluded.

United States ⚿ 70(22)

*C. Stanley Dees*, for plaintiff. *Gilbert A. Cuneo*, attorney of record. *William H. Butterfield*, *Sellers, Conner & Cuneo* and *William Eisner*, of counsel.

*Susan M. Linden*, with whom was *Acting Assistant Attorney General Irving Jaffee*, for defendant.

Before DURFEE, *Senior Judge*, NICHOLS and KASHIWA, *Judges*.

DURFEE, *Senior Judge*, delivered the opinion of the court:

The legal task before the court is one of interpreting the parties' contract. The question to be answered is whether certain clauses in the parties' contract entitled plaintiff to a price increase in its Firm Fixed-Price (FFP) contract for increased costs incurred in Canada on account of the Canadian Government's action in unpegging the fixed rate of exchange between the American and Canadian dollars and the latter currency's upward float in value during the life of the parties' contract.

The Armed Services Board of Contract Appeals (the Board) having denied plaintiff's claim [1] for a price increase in its FFP contract, the case comes before this court on plaintiff's motion and defendant's cross-motion for summary judgment. Plaintiff seeks reversal and defendant affirmance of the Board's decision under the review standards of the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970). The appeal presents solely a question of law without dispute to the operative facts.

ITT Arctic Services, Inc. (ITT-ASI),[2] an American corporation, had provided operation and maintenance (O & M) services under a series of successive management contracts with the United States Air Force on the Distant Early Warning Line (DEW Line) since its completion in 1955. The DEW Line is a network of radar and communication installations extending across large areas of the Arctic regions including Canada, Alaska and Greenland. The DEW Line's primary objective is the detection, classification and reporting of airborne objects. The present dispute involves only the Canadian portion of the DEW Line.

ITT-ASI received its first DEW Line O & M contract for fiscal year 1957. This contract was a Cost Plus Fixed Fee

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[1] ITT Arctic Services, Inc., ASBCA No. 15630, 72-1 BCA ¶ 9188.

[2] ITT Arctic Services, Inc. is the successor by corporate reorganization and contract novation agreement dated October 1, 1969 to Federal Electric Corporation, the original awardee of the present contract, and a wholly-owned subsidiary of International Telephone and Telegraph Company.

(CPFF) contract and renewed annually up to 1963. For fiscal years 1964 through 1966 plaintiff operated the DEW Line under a Cost Plus Incentive Fee (CPIF) contract. Between fiscal years 1967–1969, ITT–ASI performed O & M services on the Canadian segment of the DEW Line under a Fixed-Price Incentive Fee (FPIF) type contract. Following the issuance and evaluation of a competitive two-step multiyear Request for Proposals (RFP)[3] issued by the Air Force through the Sacramento Air Materiel Area, McClellan Air Force Base, California, plaintiff was awarded a three-year DEW Line O & M management services contract, effective July 1, 1969 for fiscal years 1970, 1971 and 1972. That contract,[4] the basis of the present dispute, was a Firm Fixed-Price (FFP) type contract with a monthly payment in U.S. dollars of $1,696,319 for a total contract price of $61,067,484. The contract's Statement of Work (SOW) provided that in addition to performing the technical operation, maintenance and support services necessary for the actual operation of the DEW Line, the contractor (ITT–ASI) would provide a wide variety of auxiliary services to its DEW Line employees including recreational and morale programs and religious, mail, medical and mortuary services.

Prior to the award of the first O & M DEW Line contract, the Governments of the United States and Canada entered into agreements governing the performance of O & M contractors on the Canadian segment of the DEW Line. These intergovernmental agreements provided that U.S. selected DEW Line contractors would give preference to Canadian labor, set and maintain wage rates and working conditions after consultation with and approval by the Canadian Department of Labour in accordance with the Canadian Fair Wages and Hours of Labour Act, and pay its Canadian labor in their domestic currency (Canadian dollars).

The United States Government assured compliance with these provisions of the U.S.-Canadian agreements by inserting in all DEW Line contracts a clause requiring contractor adherence with all U.S.-Canadian agreements. The Special Provision's Clause in plaintiff's present contract required:

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[3] RFP No. FO 4606–69–R–0131.

[4] Contract No. FO 4606–69–C–1108.

> PART V AGREEMENTS BETWEEN GOVERNMENTS
>
> The Contractor shall comply with the applicable provisions of any agreements heretofore or hereafter entered into between the Government of the United States and the Governments of Canada, Denmark, Iceland or the United Kingdom, as well as the Air Force Regulations, manuals and other applicable directives in existence on the date of the execution of this contract. In the event that any provisions of said agreements are inconsistent with the terms and conditions of this contract, this contract shall be amended accordingly. Such amendments, however, shall be subject to the provisions of ASPR 1-109.4.

On May 31, 1970 the Canadian Government removed the fixed par value of its currency, and allowed the Canadian dollars to float in the international money market. For the preceding eight years the Canadian dollar had a fixed par value exchange rate of .925 to the U.S. dollar. After the termination of Canada's fixed exchange rate the Canadian dollar fluctuated upward in value against the U.S. dollar. While floating the Canadian dollar never dipped below the previously fixed exchange rate of .925 to the American dollar. The effect of the unpegging action was that plaintiff had to exchange more U.S. dollars, in which it was paid, in order to obtain sufficient Canadian currency in which to meet its required Canadian obligations.

It is undisputed that the subsequent rise in the value of the Canadian dollar occasioned by that Government's decision to float its currency increased plaintiff's cost in meeting its contract expenses. The parties agree that the negotiations and plaintiff's computation of its price proposal regarding this contract were based on the then fixed Canadian rate of exchange of .925 to the U.S. dollar, *and that there were no discussions of a change in that rate.*

On June 5 and July 24, 1970 plaintiff requested from the Contracting Officer an upward price adjustment in its FFP contract on account of the adverse impact the higher cost of Canadian dollars was having on its cost position. Plaintiff based its request on paragraph 3 of Part IV of the Special Provisions. That part of the Special Provisions provided:

> PART IV AGREEMENTS BETWEEN GOVERNMENTS OF THE UNITED STATES AND CANADA:
>
> 1. The Contractor shall comply with all applicable Government agreements relating to Canadian participation in the operation and maintenance of the Canadian segment of the DEW Line. These agreements call for the exclusive use of Canadian sources in procuring petroleum, oils and lubricants, and transportation by air or water. However, it being understood that the POL requirements may be procured outside of Canada if costs quoted by Canadian Companies substantially exceed costs of POL which may be offered by other sources. In addition the Contractor shall accord preference to qualified Canadian Materials.
>
> 2. Wages Canadian Portion—The Wages applicable to that portion of the work to be performed in Canada must be approved by the Canadian Department of Labour. This includes the number of hours per work week as well as wage rates.
>
> 3. Wage Escalation—[hereinafter Wage Escalation clause] In the event that labor costs including fringe benefits, working conditions, or other elements of labor costs increase in Canada during the period of 69 Jul 01 through 72 Jun 30 which are in excess of those in effect as of 69 Jul 01, such increases, when required and approved by the Canadian Government will be the basis for modification of the contract price. Such increase shall not include any amount for general and administrative costs, overhead or profit nor shall an adjustment be allowed by reason of improper classification of employees.

The Contracting Officer denied plaintiff's request. On timely appeal to the Armed Services Board of Contract Appeals, the Board affirmed the Contracting Officer concluding that:

> Our conclusion is that while appellant may have incurred additional costs attributable to currency fluctuation, such costs in our opinion could not be deemed "labor costs" or "other elements of labor costs" under the wage escalation clause of the contract.[5]

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[5] 72-1 BCA ¶ 9188 at 42,597.

Plaintiff filed a petition in this court on August 28, 1973 for review of the Board's decision under both sections of the Wunderlich Act, 41 U.S.C. §§ 321, 322 (1970), alleging that the decision of the Armed Services Board of Contract Appeals was erroneous as a matter of law.[6]

Plaintiff claims that the Board erred in not interpreting the Wage Escalation clause, set forth above, as applicable to the present situation to grant plaintiff an upward price modification for the increased costs incurred on the instant contract on account of the rise in the exchange rate between the Canadian and American dollars. The Government takes the opposite view that the Board should be affirmed because it properly concluded that the Wage Escalation clause was not intended to protect plaintiff against losses due to currency fluctuations.

For the reasons below, the Government's position is sustained, and its cross-motion for summary judgment granted. Plaintiff's motion for summary judgment is denied, and its petition dismissed.

Contract interpretation questions of the meaning and applicability of a contract clause, such as the present one, require the court's determination as to what the parties shook hands on. "For it is always true that 'in the case of contracts, the avowed purpose and primary function of the court is the ascertainment of the intention of the parties.' 4 Williston, Contracts § 601 (3d ed. 1961) [other citations omitted]." *Dynamics Corporation of America* v. *United States*, 182 Ct. Cl. 62, 72, 389 F. 2d 424, 429 (1968). The rules governing such contract interpretation, the sole issue in this case, are well settled and without need of elaborate reiteration. In attempting to give effect to the contracting parties' intent, the court is guided by the principles that "[t]he parties' intent must be gathered from the instrument as a whole." *Kenneth Reed Constr. Corp.* v. *United States*, 201 Ct. Cl. 282, 288, 475 F. 2d 583, 586 (1973), preferably giving a reasonable meaning to all parts of the instrument rather than leaving a portion of it useless, *Martin Lane Company, Inc.* v. *United States*, 193 Ct. Cl. 203, 215, 432 F. 2d 1013, 1019 (1970), from the perspective of "a reasonably intelligent person acquainted with the contemporary circumstances." *Firestone Tire & Rubber Co.* v. *United States*, 195 Ct. Cl. 21, 30, 444 F. 2d 547, 551 (1971), and ascribing to the contract language "its ordinary and commonly accepted meaning", *Hol-Gar Manufacturing Corp.* v. *United States*, 169 Ct. Cl. 384, 390, 351 F. 2d 972, 976 (1965), without twisted or strained out of context analysis, *Aero Mayflower Transit Co.* v. *United States*, 162 Ct. Cl. 233 (1963), or regard to the subjective unexpressed intent of one of the parties. *Dana Corp.* v. *United States*, 200 Ct. Cl. 200, 214, 470 F. 2d 1032, 1041 (1972); *John C. Kohler Co.* v. *United States*, 204 Ct. Cl. 777, 787, 498 F. 2d 1360, 1365 (1974).

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[6] While plaintiff in its Motion for Summary Judgment (Pltf's M. for S.J. 1–2) makes a general assertion of possible factual deficiencies in the Board's decision, it makes no specific identifiable charges of factual error. Without such specific supported demonstration of factual Board error the Board's statement of facts will be accepted. *Jefferson Constr. Co.* v. *United States*, 177 Ct. Cl. 581, 589, 368 F. 2d 247, 252 (1966).

Further, both parties are presumed to possess elementary commercial intelligence, *Franklin Co.* v. *United States*, 180 Ct. Cl. 666, 381 F. 2d 416 (1967), and "approach their undertaking with a reasonably clear understanding of the attendant complexities and consequences." *Massachusetts Port Authority* v. *United States*, 197 Ct. Cl. 721, 726, 456 F. 2d 782, 784 (1972).

In the event of multiple reasoned opposing views of a contract clause, the interpretation of the non-drafting party will prevail. *Kenneth Reed Constr. Corp.* v. *United States*, 201 Ct. Cl. at 289, 475 F. 2d at 588. The court's "ultimate goal is always to give full force and effect to the express or implied intentions of the contracting parties." *Massachusetts Port Authority* v. *United States*, 197 Ct. Cl. at 726, 456 F. 2d at 784.

Application of these principles leads to the conclusion that in assessing the surrounding circumstances and contract language, the Wage Escalation clause was not intended to protect plaintiff from currency exchange rate fluctuations.

Throughout plaintiff's thirteen-year contractual performance on the DEW Line, it was continuously subject to the Canadian Government's exercise of its power to upwardly adjust plaintiff's labor costs. The parties negotiated all their DEW Line O & M contracts with the awareness that under a prior U.S.-Canadian agreement predating the first DEW Line O & M contract[7] and implementing contract clauses appearing in every such contract since 1957, plaintiff was obligated to accede to the directives of Canadian authorities with regard to their Canadian labor's wages and various other benefits. The parties negotiated their presently disputed contract with a fuller awareness that Canadian authorities could increase plaintiff's costs by increasing its Canadian labor's wages, but without regard, as the parties admit, to the potentiality of an increase in the U.S.-Canadian currency exchange rate. The parties' awareness of the Canadian Government's unilateral power under the prior Canadian-American DEW Line agreement, contractually incorporated in plaintiff's contract, to adversely affect plaintiff's labor costs was born of recent practical experience. Only four years prior to the execution of the parties' instant contract, plaintiff had to petition the Board for price relief stemming from the Canadian Government's refusal to approve plaintiff's proposed Canadian wage rates in the parties' contract for fiscal years 1964–1966. In that case, *Federal Electric Corporation*, ASBCA No. 9476, 65–1 BCA ¶4747, plaintiff's Cost Plus Incentive Fee contract did not contain a provision for escalation of the contract price for the Canadian Government's increase in plaintiff's labor costs. The Board could find no contractual basis for awarding plaintiff relief, but nonetheless adjusted plaintiff's incentive fee formula to effect the parties' Cost Plus Incentive Fee contractual intent that the contractor not lose a large portion of its proposed target fee upon the occurrence of a particular event beyond the control of either party.

The Wage Escalation clause, Special Provisions Part IV, paragraph 3, *supra*, first appeared in the parties' next contract immediately following the Board's *Federal Electric*

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[7] The relevant part of that U.S.-Canadian agreement was set forth in the Board's Findings of Fact:

"The 5 MAY 1955 agreement between the United States and Canadian Governments required that preference be given to Canadian labor for construction in Canada; and that:

'* * * The rates of pay and working conditions for this labour will be set after consultation with the Canadian Department of Labour in accordance with the Canadian Fair Wages and Hours of Labour Act.'" 72–1 BCA ¶9188 at 42,592.

While the above provision of the U.S.-Canadian agreement initially applied only to the construction of the DEW Line, it was extended in July 1955 to apply also to the operation of the DEW Line.

*Corporation* decision in the parties' contract for fiscal years 1967–1969. Its appearance immediately following the end of litigation over contractor's relief for Canadian-imposed upward adjustments in plaintiff's Canadian wage rates indicates the parties' intent to contractually protect plaintiff from certain increases. The clause's timely appearance specifically reflects the parties' intent to protect plaintiff from those increases which could adversely affect plaintiff's cost position over a multi-year contract from actions of the Canadian Government which with respect to rates of pay and working conditions that Government exercised unrestricted, unilateral control over by the prior American-Canadian agreement and binding on plaintiff by appropriate contract clauses. Such is the purpose of an escalation clause as described by the Armed Forces Procurement Regulations:

> § 3.404–3 Fixed-price contract with escalation.
>
> (a) *Description.* The fixed-price contract with escalation provides for the upward and downward revision of the stated contract price upon the occurrence of certain contingencies which are specifically defined in the contract. * * *[8]

At the time of the introduction of the Wage Escalation clause the only certain contingency specifically confronting the parties was the Canadian Government's adjustment of plaintiff's Canadian labor's wages and benefits. The U.S.-Canadian currency exchange rate had remained unchanged for over eight years. There is no evidence of discussions between the parties at the time of the introduction of the Wage Escalation clause in 1967 of a change in the then existing currency exchange rate, and the parties admit that during negotiations for the present contract neither party raised the possibility of a U.S.-Canadian currency exchange rate change nor discussed Parts IV and V of the contract's Special Provisions. Further evidence of the parties', and plaintiff's in particular, disregard for the possibility of a currency exchange rate change is the elimination of a protective Foreign Exchange provision, included in the parties' contract for fiscal years 1967, 1968 and 1969, from the presently disputed contract. That Foreign Exchange provision applied only to computation of plaintiff's incentive fee, and was appropriately eliminated when the parties switched from an incentive fee type contract to a Firm Fixed-Price contract. Plaintiff formerly insisted on a protective Foreign Exchange clause to guard against currency exchange rate diminutions of its incentive fee to protect only its incentive fee in that type of contract, which also contained the present Wage Escalation clause, where without it, plaintiff stood to lose only a portion of its fee (profit). Plaintiff's failure to insist on the same type of protective clause under its FFP contract where, without such a clause, plaintiff stood to lose not only its entire profit, but also part of its costs, is indicative of a lack of concern over the possibilities of an adverse currency exchange rate fluctuation.

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[8] 32 C.F.R. § 3.404–3(a) (1969).

The language of the disputed contract clause(s) is directly in line with and protectively implementative of the parties' recognized contingency of action by the Canadian Government raising the wage levels or benefits of plaintiff's Canadian labor, and correspondingly contrary and unimplementative of an intent on the part of the parties to include therein currency exchange rate fluctuation protection.

Part IV of the parties' contract's Special Provisions is captioned "AGREEMENTS BETWEEN GOVERNMENTS OF THE UNITED STATES AND CANADA" and contains three paragraphs. Owing to the specific caption of this Special Provision's part, the paragraphs included therein must be read as setting forth the parties' understanding as to their respective contractual obligations regarding U.S.-Canadian agreements.

The first paragraph of this part, *supra*, provided that:

> "1. The Contractor shall comply with all applicable Government agreements relating to Canadian participation in the operation and maintenance of the Canadian segment of the DEW Line. * * *"

The remainder of the paragraph deals with certain DEW Line materials and specifies that U.S.-Canadian agreements call for exclusive use by the contractor of Canadian source petroleum, oils, and lubricants (POL) and air or water transportation. In addition, the contractor was to accord preference to qualified Canadian materials. The paragraph also provides a price escape mechanism from the Canadian POL exclusive use requirement by providing that the contractor's "POL requirements may be procured outside of Canada if costs quoted by Canadian Companies susbtantially exceed costs of POL which may be offered by other sources." Thus, in the event of substantial price increases in Canadian POL products, the contractor could avoid such adverse impact on its contract costs which, absent such a provision, it would be obligated to absorb by the prior U.S.-Canadian agreement regarding DEW Line supplies incorporated in its contract by resort to other non-Canadian POL sources. The paragraph is specifically tailored to provide for plaintiff's exclusive use of Canadian POL supplies necessitated by a U.S.-Canadian agreement to the same effect yet provides relief to the contractor to escape the burden of the exclusive use Canadian-POL requirement if such prices should substantially increase in Canada during the life of its contract.

Paragraph 2 under the agreements between the Canadian and American Governments' Special Provisions part of the parties' contract deals with plaintiff's Canadian labor obligations. That paragraph acknowledges the Canadian Government's control of the wage rates and working conditions of plaintiff's Canadian labor, and specifies plaintiff's obligation under its contract to abide by the prior intergovernmental agreement, and set and maintain its Canadian labor's wage rates, working conditions and assorted other benefits in accord with the directives of the Canadian Department of Labour. Unlike the preceding paragraph, paragraph 2 contains no relief mechanism to aid plaintiff in the event of a Canadian-imposed wage increase or upward adjustment in the cost of related benefits. Absent such a provision, plaintiff would be at a serious cost disadvantage on its multi-year FFP contract should the Canadian Government exercise its right under the prior U.S.-Canadian agreement to adjust upward the wage rates or working conditions of plaintiff's Canadian labor over the life of the parties' contract. The effect of plaintiff's bargain to perform DEW Line O & M services, 90 percent of the cost of which are labor costs, on a firm fixed-price basis, coupled with its relinquishment of control over various labor cost items to Canadian authorities, directly subjected plaintiff to the risks of uncontrollable labor cost increases which, due to its contractual agreement to be bound by such increases, could have a disastrous impact on plaintiff's earnings.

Confronted with such foreseeable risks of predictable adverse impact, one would reasonably expect the novice, let alone the experienced contractor, to protect itself against the consequences of unavoidable third-party increases in its labor costs.

Paragraph 3 of Part IV of the parties' contract's Special Provisions was obviously designed to obviate such risks the same as the escape mechanism in paragraph 1 of the same part regarding plaintiff's exclusive use requirement of Canadian POL products. Paragraph 3 in material part provides that:

> 3. Wage Escalation—In the event that labor costs including fringe benefits, working conditions, or other elements of labor costs increase in Canada [during the life of the parties' contract] such increases when required and approved by the Canadian Government will be the basis for modification of the contract price. * * *

Paragraph 3 following as it does the paragraphs dictating that plaintiff shall observe all U.S.-Canadian agreements, and specifically setting forth plaintiff's obligation to observe Canadian control of its wage rates, and other identifiable labor costs in its contract's Special Provisions part concerning agreements between those two Governments leads to the conclusion that the labor costs referred to are only those under the direct control of the Canadian Government by virtue of the prior U.S.-Canadian agreement.

The clause contains other indications of this same conclusion. Paragraph 3 is titled Wage Escalation. Control of wage levels by virtue of both the prior U.S.-Canadian agreement and paragraph 2 are in the exclusive province of Canadian authorities. The general terms "labor costs" and "other elements of labor costs" are refined by the more specific terms "fringe benefits" and "working conditions". Again, both the prior U.S.-Canadian agreement and the parties' contract place control of these specific labor costs elements in the unrestricted hands of the Canadian Government.

Finally, paragraph 3 specifies that to be the basis of a contract price modification, any labor cost increases must be "required and approved by the Canadian Government." Such a restriction undeniably and restrictively limits potential contract price modification labor cost increases only to those within the unrestricted and unilateral power of the Canadian Government to effectuate. The only labor cost increases undeniably and unrestrictively within the control of the Canadian Government to impose upon plaintiff were cost increases in the levels of plaintiff's Canadian labor's wages, fringe benefits and working conditions unconditionally surrendered to Canadian control under the American-Canadian agreement.

Cost increases due to currency exchange rate fluctuations resulting from the Canadian Government's action in unpegging the fixed American-Canadian currency exchange rate were not cost increases the Canadian Government could unilaterally impose upon plaintiff under U.S.-Canadian agreement. No such intergovernmental agreement existed regarding the maintenance or adjustability of the Canadian-American currency exchange rate. Neither were they cost increases which the Canadian Government could require or control unilaterally. Exchange rate increases in an international floating currency are not within the sole control, approval or direction of the floating country.

The net result of objectively examining the contemporary circumstances giving rise to the Wage Escalation clause, its uncritical inclusion in the presently disputed contract, and the language of the clause, supports the conclusion that the parties reasonably intended to relieve plaintiff of the risks of labor cost increases attendant to the Canadian Government's exercise of the control under prior U.S.-Canadian agreements to raise the cost of plaintiff's Canadian labor. Such labor costs were, however, limited to only those which plaintiff had contractually surrendered control of to Canadian authorities pursuant to such an agreement, and accordingly, do not include increased floating currency costs.

Plaintiff's primary contention is that the common ordinary meaning of the contract clauses in Part IV of the Special Provisions entitles it to an upward price modification. Subsidiary to this argument is plaintiff's assertion that the Government's interpretation of the contract clauses denying plaintiff relief is unreasonable or alternatively conceding the reasonableness of the Government's interpretation, plaintiff should still prevail under the rule of *contra proferentem.* In addition, plaintiff argues that it is entitled to relief even without Part IV, paragraph 3 of the Special Provisions of its contract. Apparently, as an afterthought, plaintiff, in its last submission to the court, urges the court to reform its contract on the basis of mutual mistake of fact.

As the prime basis for its recovery, plaintiff asserts that the broad language of the Wage Escalation clause stands for the unqualified proposition that whenever resultant to an act of the Canadian Government plaintiff's cost of paying its employees increases, plaintiff is entitled to an upward contract price modification. Such an interpretation of the Wage Escalation clause we find to be cumulatively unreasonable, unsupported by the contract language, and contrary to the parties' intent.

A survey of the prevailing contemporary circumstances, both from the commencement of plaintiff's DEW Line O & M contract performance, and at the inception of the Wage Escalation clause discloses the parties' overriding concern for the Canadian Government's control over the cost of wages and related labor benefits that plaintiff must pay under its contract agreement, and coincidentally, no concern whatever for fluctuations in the Canadian currency exchange rate or its impact on plaintiff's costs. Plaintiff ignores this limited protective consideration, and its acquiescence in it in postulating that merely because it paid an increased price for Canadian dollars with which to pay its Canadian labor, the same is an increased labor cost entitling plaintiff to a contract price modification. Rather, plaintiff seeks to support its position by focusing on the wording of paragraphs 2 and 3 of Part IV of the Special Provisions. Plaintiff points out that paragraph 2 speaks in terms of "wages" and the "Canadian Department of Labour," while paragraph 3 refers to "labor costs" and actions by the "Canadian Government." By comparing these two paragraphs, plaintiff asserts that paragraph 3, the Wage Escalation clause, is broader than paragraph 2, and intended to cover more than wage increases. We agree, as does defendant, that the Wage Escalation clause in Part IV of the Special Provisions is broader than paragraph 2 of that same part, and intended to cover more than wage increases. However, we do not agree with plaintiff's deduction that paragraph 3 being broader than paragraph 2, the former paragraph was intended to cover *any* increase in the cost of paying plaintiff's Canadian employees resulting from Canadian Government action, or that the common, ordinary meaning of the Wage Escalation clause includes protection for currency exchange rate fluctuations.

Plaintiff's assertion that its expense of independent currency transactions to secure Canadian dollars to pay both for Canadian labor and materials transforms a portion of that expense into labor costs must be rejected as unsupported by persuasive reason.

We see no reasoning, other than that of a strained variety, to logically accept plaintiff's argument that any cost of paying its Canadian labor must redoubtably be a labor cost. Plaintiff relies on the attenuated logic that a "cost" is something incurred by an employer, hence, plaintiff's cost of Canadian dollars with which to pay its Canadian labor must be a labor cost. Plaintiff points to no supportive reasoning or authority that any costs a business concern may incur in paying its employees are definitely labor costs alone. Under plaintiff's argument, the cost of check paper, bookkeeper's ink, computer data or a host of other goods and services utilized toward seeing that a laborer receives his wages would to plaintiff constitute a labor cost. Such a position cannot be sustained as reasonable or supported by the contract language. In fact, the Wage Escalation clause specifically excludes from labor cost increases entitling plaintiff to a contract price modification "any general and administrative costs, overhead or profit." In doing business in a foreign country, the purchase of that country's currency to meet contractor's local obligations is an expense attributable to the overall operation of the concern, and not naturally or reasonably attributable alone to either the cost of labor or supplies. Rather, the cost of currency ultimately expended for both of these items and other necessary elements of a business operation more reasonably must be classified as a general expense as the incurrence of the currency cost is of both general and necessary benefit to all phases of an international contractor's operations.

Even accepting plaintiff's strained reasoning that the cost of Canadian currency must be considered a labor cost, and ignoring the Wage Escalation clause's specific prohibition against the inclusion of general expenses in the computation of labor cost increases eligible for contract price modifications under that clause, plaintiff's asserted right to a contract price modification under the Wage Escalation clause is defeated by the explicit language of that clause. The Wage Escalation clause specifies that only those labor cost increases "required and approved" by the Canadian Government will be the basis of a contract price modification. This language restricts consideration of a contract price modification for increased labor costs to those increases mandated by the Canadian Government, and requires a showing that the Canadian Government directed an increase in plaintiff's cost of labor.

Plaintiff's increased currency costs resulted from the Canadian Government's decision to eliminate the fixed rate of exchange for the Canadian dollar, and that currency's subsequent rise in exchange value. That decision to remove the fixed exchange rate between the U.S. and Canadian dollars opened three distinct possibilities. The Canadian dollar after May 31, 1970 could have, but was not required, to decline, rise or remain stable in value. In floating its currency, the Canadian Government surrendered control over the international exchange rate of the Canadian dollar, and was powerless to require or approve changes in its exchange value. The Canadian Government being unable to require changes in the exchange rate of the floating dollar, the changes in the Canadian dollar's exchange rate resulting in higher costs to plaintiff was without the approval or requirement of that Government, as required by the Wage Escalation clause.

As the Canadian Government's action in allowing its dollar to float neither required nor approved increases in plaintiff's contract costs, that action does not qualify as a basis for contract price modification under the Wage Escalation clause.

The restriction in the Wage Escalation clause limiting contract price modifications to those labor cost increases required and approved by the Canadian Government supports defendant's interpretation and the court's conclusion that the Wage Escalation clause was intended by the parties to alleviate the risks attendant to the Canadian Government's control, under prior U.S.-Canadian agreements, of contractor's Canadian labor's wages and collateral benefits costs. That restriction assures the contractor of price protection for all labor costs controlled by the Canadian Government, and simultaneously delineates defendant's potential contract price modification obligations to those specific labor costs which, under the prior U.S.-Canadian agreements, the Canadian Government could unilaterally impose on the contractor. This interpretation which confines contract price modifications to these specific labor costs not only comports with the intent of the parties, and the language of the Wage Escalation clause, but is consistent with the ASPR requirement limiting price escalation in fixed-price contracts to "certain contingencies which are specifically defined in the contract."[9]

In addition to relying on the language of the Wage Escalation clause, plaintiff seeks to support its position by reference to the history and parties' course of conduct on all other DEW Line procurements. Plaintiff contends that under all other DEW Line contracts, except plaintiff's presently disputed one, defendant and not plaintiff bore the risk of currency exchange rate fluctuations, and that risk was not shifted to plaintiff by osmosis[10] by the mere change from an FPIF contract to an FFP contract.

Complementing this argument is plaintiff's assertion that the court should follow the Board's rationale in *Federal Electric Corporation*, *supra*, and grant plaintiff price relief as the ASBCA did, even disregarding the Wage Escalation clause, to effectuate the parties' true contractual intent as implied from the terms of their agreement. Both of these arguments must be rejected.

While osmosis may be an ineffectual method of shifting substantial cost risks, we find nothing osmotic in the shift of the risk of currency exchange rate fluctuations in the parties' deliberate shift from their prior cost and incentive type of contracts to an FFP contract, especially where the Board found nothing to suggest that the parties were unaware of the distinguishing characteristics of an FFP contract, or that the measured progression through contract types was inadvertent.[11]

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[9] Id.

[10] Plaintiff's brief, p. 22.

It has long been recognized that in FFP contract situations the payee party, absent a specific contrary contract provision, assumes the risk of currency valuation changes. *Legal Tender Cases*, 79 U.S. (12 Wall.) 457 (1871); *Deutsche Bank Filiale Nurnberg* v. *Humphrey*, 272 U.S. 517, 519 (1926). The Armed Services Procurement Regulations which are law binding on the parties in a Government contract and govern the interpretation of the contract, *Chris Berg, Inc.* v. *United States*, 192 Ct. Cl. 176, 182, 426 F. 2d 314, 317 (1970), acknowledge the FFP contractor's assumption of full responsibility for *all* costs over the firm fixed-price.[12] Plaintiff errs in arguing that in signing its FFP contract it accepted only identified risks within its power to control.

> We have consistently held that the contractor in a fixed-price contract assumes the risk of unexpected costs. *Sperry Rand Corp.* v. *United States*, 201 Ct. Cl. 169, 181, 475 F. 2d 1168, 1175–76 (1973); *Aerojet-General Corp.* v. *United States*, 199 Ct. Cl. 422, 434, 467 F. 2d 1293, 1300–01 (1972); *Rolin* v. *United States*, 142 Ct. Cl. 73, 82, 160 F. Supp. 264, 268–69 (1958). *See also* 3 Corbin, Contracts § 598 (2d ed. 1960) at 590. In firm fixed-price contracts, risks fall on the contractor, and the contractor takes account of this through his prices. Nash, *Risk Al-*

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[11] *ITT Arctic Services, Inc., supra*, n. 1. at 42,595.

[12] 32 C.F.R. § 3.404–2 (1969):

§ 3.404–2 Firm fixed-price contract.

"(a) *Description.* The firm fixed-price contract provides for a price which is not subject to any adjustment by reason of the cost experience of the contractor, in the performance of the contract. This type of contract, when appropriately applied as set forth below, places maximum risk upon the contractor. Because the contractor assumes full responsibility, in the form of profits or losses, for all costs under or over the firm fixed-price, he has a maximum profit incentive for effective cost control and contract performance. Use of the firm fixed-price contract imposes a minimum administrative burden on the contracting parties."

* * * * *

*location in Government Contracts*, 34 Geo. Wash. L. Rev. 693, 694–96, 701–02 (1966).[13]

Equally without legal significance is plaintiff's statement that in signing its FFP contract it did not agree to accept the risk of currency exchange rate fluctuations. *Kenneth Reed Constr. Corp.* v. *United States*, 201 Ct. Cl. at 291, 475 F. 2d at 588.

Despite the historic locus of the currency exchange rate fluctuation risk burden under all other DEW Line O & M contracts, the fact remains that in accepting an FFP contract, plaintiff accepted the risk and responsibility "for *all* costs under or over the firm fixed-price".[14] This was a risk repeatedly held to include changes in currency values, and we find nothing unfair, unreasonable or illogical in holding the parties to the terms of their FFP contract, and enforcing the rule that:

> * * * Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered. * * *. *United States* v. *Spearin*, 248 U.S. 132, 136 (1918).

In *Federal Electric Corporation*, *supra*, the Board, unable to find any contractual basis for a price adjustment in plaintiff's CPIF contract, granted plaintiff price relief to give effect to the parties' true contractual intent that plaintiff's incentive fee be reduced only for cost increases within plaintiff's general management control risk, and not by events beyond the control of either party. Plaintiff urges the court to apply the *Federal Electric* rationale and grant plaintiff price relief in the absence of a contractual provision to effectuate the true contractual intent of the parties. Plaintiff failed to make this argument to the Board, even though, as plaintiff asserts, "[t]he facts presented in this litigation are, in all relevant respects, identical to those presented in the *Federal Electric* appeal." *Plaintiff's Reply Brief* at p. 13. In making this argument, plaintiff ignores the significant differences between the CPIF contract in *Federal Electric* and the FFP contract in the instant case, and that the Board's decision in the latter case was motivated by regard for "the goal inherent in incentive contracting." *Federal Electric Corporation*, *supra*, at 22,573. Our assessment of the parties' true contractual intent in the present case must likewise be motivated by regard for the different goal inherent in FFP contracting. That intent is adequately evidenced by the parties' use of an FFP contract. FFP contracting places maximum risk on the contractor for all costs over the fixed price including unanticipated ones. There is no evidence that defendant intended to reduce plaintiff's assumption of cost risks other than by way of the Wage Escalation clause. Absent such evidence the goal inherent in FFP contracting, that plaintiff bear all costs without additional compensation, must be regarded as the parties' true contractual intent. We see no basis, other than the Wage Escalation clause, inapplicable in the present case, to relieve plaintiff of the burden of currency exchange rate fluctuations.

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[13] *McNamara Construction of Manitoba, Ltd.* v. *United States*, 206 Ct. Cl. 1, 8, 509 F. 2d 1166, 1169–70 (1975).

[14] 32 C.F.R. § 3.404–2(a) (1969) (Emphasis added).

Plaintiff's argument in this regard is likewise inconsistent with its summation statement that "[w]hen all the rules and aids are stripped away, the basic question is whether *this* plaintiff is entitled to relief under *this* contract by virtue of a specific contract clause." *Plaintiff's Reply Brief* at p. 2.; Plaintiff's emphasis.

Plaintiff attempts to bolster the validity of its interpretation of the disputed contract clauses by ascribing to the Government an untenable interpretation, denied by the Government, of the same contract clauses, and labeling it unreasonable. Thus, plaintiff argues that since the Government's interpretation is unreasonable, and plaintiff's interpretation reasonable, the former must be rejected, and the latter prevail. This is an artificial conclusion.

Plaintiff erroneously casts the Government's interpretation of the disputed clauses as essentially treating the words in paragraphs 2 and 3 of Part IV of the contract's Special Provisions as synonymous, and entitling plaintiff to a contract price modification only when the Canadian Department of Labour orders a wage or salary increase. Defendant's interpretation plaintiff refutes as unreasonable by pointing to the obvious differences in the meaning and breadth between the words "wages" and "Canadian Department of Labour" employed in paragraph 2, and the words "labor costs" and "Canadian Government" utilized in paragraph 3, and concluding an interpretation treating them synonymously is unreasonable as contrary to the plain meaning of the words, and volitive of several recognized fundamental rules of contract interpretation. This unreasonable "Government" interpretation, plaintiff argues, must be rejected.

Plaintiff's argument must be rejected as based on an erroneous view of the Government's interpretation of the disputed contract clauses. Defendant admits the use of the different terms in the two paragraphs was intended to broaden the protective contract price escalation coverage afforded plaintiff under the Wage Escalation clause to include more than just wage increases ordered by the Canadian Department of Labour. Defendant acknowledges that action of Canadian Government agencies other than the Canadian Department of Labour could increase plaintiff's labor costs, and that under the Wage Escalation clause, plaintiff would be entitled to an upward price modification for these increases. It cites as an example of such increases entitling plaintiff to a contract price modification for increased labor costs the imposition by Canadian health authorities of new more costly health services for plaintiff's Canadian labor. Plaintiff likewise provides another similar example of such a protected increase in citing *Morrison-Knudsen Co.* v. *United States*, 192 Ct. Cl. 410, 427 F. 2d 1181 (1970), wherein the court granted the contractor price relief from the U.S. Congress' imposition of increased Social Security taxes. If the Canadian Government had imposed or increased employment taxes on plaintiff, undoubtedly such increases would entitle plaintiff to a contract price increase. In short, Part IV, paragraph 3 of the parties' contract's Special Provisions reasonably provides, as defendant contends, price escalation for a wide variety of labor cost increases the Canadian Government could impose on plaintiff, and not only for wage increases ordered by the Canadian Department of Labour. However, as indicated above, that clause does not reasonably purport to afford plaintiff price escalation protection for currency exchange rate increases.

Collateral to the above argument is plaintiff's assertion that conceding the reasonableness of defendant's contract interpretation, plaintiff should prevail under the rule of *contra proferentem.* The necessary precursor for resort to the rule of *contra proferentem* is the determination that a contract clause is ambiguous, *i.e.*, susceptible of more than one reasonable interpretation.[15] "Contracts are not necessarily rendered ambiguous by the mere fact that the parties disagree as to their meaning. There must be a reasonable uncertainty of meaning." *Southern Constr. Co.* v. *United States*, 176 Ct. Cl. 1339, 1361, 364 F. 2d 439, 452–53 (1966). As we have concluded that the Wage Escalation clause is susceptible to only one reasonable interpretation, and no reasonable uncertainty exists as to that interpretation, the *contra proferentem* rule cannot be applied in plaintiff's favor.

As an alternative remedy only plaintiff urges the court to reform the contract on the basis of the parties' mutual mistake of fact. Plaintiff bases its contract reformation claim on the assertion that both parties entered the contract mistakenly assuming that the Canadian exchange rate would remain static during the life of the parties' agreement. In support of this contention, plaintiff points to evidence establishing that neither party gave any thought at all to the possibility of a change in the Canadian exchange rate existing at the outset of the parties' contract. The evidence does not, however, establish that defendant shared plaintiff's assumption as to the continued stability of the Canadian exchange rate or that defendant would have agreed to plaintiff's proposed reformation at the same FFP contract price.

The court's decision in *McNamara Constr. of Manitoba, Ltd.* v. *United States*, 206 Ct. Cl. 1, 509 F. 2d 1166 (1975), renders unnecessary extensive discussion in disposing of this argument. In *McNamara* the court denied an FFP contractor contract reformation relief for its higher labor costs due to labor unrest beyond contractor's control. The court repudiated the availability of contract reformation for mutual ignorance:

> For reformation we would need some antecedent expressions by the parties at variance with the terms of the contract or some articulated mutual assumption regarding

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[15] *See, J. W. Bateson Co.* v. *United States*, 196 Ct. Cl. 531, 543, 450 F. 2d 896, 902 (1971).

> [Canadian exchange rates] behavior which we could incorporate into the agreement or some indication that a mutual mistake existed as to a hard fact on which the parties had based the contract. * * * [16]

Plaintiff's failure to show any of the above elements or that defendant "would have been willing if it had known the true facts from the beginning, to bear a substantial part of the additional expenses." *National Presto Industries, Inc.* v. *United States*, 167 Ct. Cl. 749, 769, 338 F. 2d 99, 112 (1964), *cert. denied*, 380 U.S. 962 (1965), precludes contract reformation.

On *de novo* consideration of plaintiff's claim, we concur with the Board's decision that the Wage Escalation clause in plaintiff's contract does not afford price modification protection for the increased costs of floating Canadian currency.

Accordingly, defendant's cross-motion for summary judgment is granted. Plaintiff's motion for summary judgment is denied. The petition is dismissed.

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524 F. 2d 693

## HORTON J. BROWN, Individually, as Assignee of RAY BROWDER, and d/b/a WESTERN ELECTRICAL & MECHANICAL SYSTEMS, B & B CONSTRUCTION CO., and PUGET SOUND BUILDERS v. THE UNITED STATES *

[No. 251-72. Decided October 22, 1975]

ON DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

**Contracts; fraud against the United States; False Claims Act; collateral estoppel; counterclaim.**—Plaintiff, a general contractor, claims damages for alleged breach of contracts embodied in purchase orders with the Department of Housing and Urban Development (HUD). The contracts at issue evolved from "Area Management Broker" contracts (AMB) (governed by HUD regulations and policies) which HUD entered into with an individual d/b/a Berg Realty Company (Berg) for repair and subsequent sale of various properties which HUD had acquired through foreclosures and sales. Regulations required Berg to solicit at least three competitive bids for various craft renovation jobs and HUD policies prohibited one contractor from receiving more than one craft job on each FHA property. During 1970–1972, plaintiff worked on properties covered by HUD's AMB contract with Berg, and, according to defendant, entered into a conspiracy with individuals to circumvent HUD regulations and policies, whereby he received all the invitations to bid for each item open for bid and, via "companies" created solely for bidding purposes, rigged the bids so that he was always successful. In August 1972 an 18 count indictment covering some of the contracts between plaintiff and HUD was returned against plaintiff, Ray Browder and Berg officials. On November 24, 1972 a jury found plaintiff and the co-conspirators guilty as charged. On June 16, 1972 in his own right and as the alleged assignee of Ray Browder plaintiff filed the petition in this court. In addition to his breach of contracts claims, plaintiff seeks (claim 3) recovery for certain emergency work allegedly performed pursuant to oral instructions from a Government agent; claims that he was not awarded 11 contracts for which he was the low bidder in violation of the provisions of 41 C.F.R. §§ 1–1.-1202(d) and 1–1.1204–1(b), and that accordingly he is entitled to lost profits; and further asserts that this court lacks jurisdiction to hear defendant's counterclaim for money damages under the False Claims Act, 31 U.S.C. §§ 231–35. Defendant contends that, in view of plaintiff's fraudulent activity, HUD had the power to cancel all of the contracts listed in plaintiff's claims 1 and 2, and therefore that no payments were due on the subject purchase orders. It is *held* (1) that the alleged assignments to plaintiff of Browder's rights to payment or awards under the latter's contracts are invalid as not complying with an Assignment of Claims Act; (2) (a) that plaintiff is estopped from denying his fraudulent activity as to those contracts forming the basis for his criminal indictment and conviction, (b) that defendant has the legal right to cancel those contracts found to have been obtained in violation of 18 U.S.C. § 1001, and (c) that as to those contracts which did not form the basis of plaintiff's conviction, collateral estoppel does not apply and plaintiff's affidavit denying that he knowingly and intentionally practiced or attempted to practice fraud against the United States creates an issue of fact as to which a trial is necessary; (3) that plaintiff's claim seeking recovery for emergency work allegedly performed pursuant to oral instructions from a Government agent fails because the alleged actions were unauthorized and conferred on plaintiff no right to recover; (4) that plaintiff is not entitled to recover lost profits; (5) that the court has jurisdiction over defendant's counterclaim for money damages under the False Claims Act; (6) that under the False Claims Act defendant is entitled to $2,000 for each purchase order forming the basis for plaintiff's criminal indictment and conviction; and (7) that a trial is necessary on the issue of the amount of actual damages sustained by defendant. The case is remanded to the trial division for further proceedings consonant with this opinion, and entry of judgment dismissing plaintiff's claims as to which he is not entitled to recover is deferred pending final disposition of the case.

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[16] *McNamara Construction of Manitoba, Ltd.* v. *United States, supra*, 206 Ct. Cl. at 10, 509 F. 2d at 1171.

*Opinion amended pursuant to order dated January 9, 1976.

**Contracts; Assignment of Claims Act; generally.**

[1] Where plaintiff does not fall within the "financing institution" exception to the Assignment of Claims Act and has not demonstrated compliance with the procedures mandated by said Act respecting alleged assignments to him of contractor's rights to payment or awards under the latter's Government contracts, the assignments are void as against the United States under the statute.

**United States 🔑 111(6)**

**Pleading and practice; summary judgment; when appropriate.**

[2] In a suit to recover payments allegedly due on certain Government contracts, where defendant has moved for summary judgment on the basis of plaintiff's conviction for violating 18 U.S.C. §§ 1001 and 371 by having conspired with various individuals to circumvent regulations in obtaining the contracts, and plaintiff has denied here such activities in an affidavit, defendant, in order to prevail on its motion for summary judgment, must show why plaintiff is estopped from claiming that his prior activities in obtaining the contracts were entirely correct and "above-board."

**Courts 🔑 470**

**Judgments; prior adjudications; criminal proceedings; effect of on later civil proceedings.**

[3] Prior criminal conviction may work an estoppel in a subsequent civil proceeding. Thus, as to those contracts involved in the present suit which formed the basis for plaintiff's conviction of violating 18 U.S.C. §§ 1001 and 371, plaintiff is estopped from denying his fraudulent activities in obtaining the contracts.

**Judgment 🔑 648**

**Fraud; remedies of Government; cancellation of contract.**

[4] That 18 U.S.C. § 1001 provides a fine for making fraudulent statements, etc. respecting any matter within the jurisdiction of any department or agency of the United States, does not preclude, as an alternative remedy, the Government's cancellation of contracts proven to be "tainted" by the fraud.

**United States 🔑 72(7)**

**Judgments; former adjudication; collateral estoppel; criminal conviction; effect on civil proceeding.**

[5] Only those questions distinctly put in issue and directly determined in a criminal prosecution can be utilized in a civil proceeding to collaterally estop a litigant. Thus, as to those contracts involved in the present suit which did not form the basis of plaintiff's conviction of violating 18 U.S.C. §§ 1001 and 371, collateral estoppel does not apply, and plaintiff's affidavit denying that he knowingly

and intentionally practiced or attempted to practice fraud against the United States, creates an issue of fact and warrants trial on the issue of cancellation of those contracts.

Judgment ⚷ 648

**Contracts; authority of Government agent; unauthorized act of agent; Government not bound by.**

[6] The United States is not bound by the unauthorized acts of its agents. A person dealing with the United States is deemed to have notice of the extent of the agent's authority, and it is that person's responsibility to show that the agent was acting within the bounds of his authority.

United States ⚷ 40

**Contracts; damages; measure of damages; anticipated or lost profits; recovery of by unsuccessful bidder.**

[7] Regardless of the reasons for the Government's failure to award a contract to an unsuccessful bidder, the latter cannot recover anticipated or lost profits where the contract under which he would have made such profits never actually came into existence.

United States ⚷ 64

**Court of Claims jurisdiction; counterclaims; False Claims Act.**

[8] Under 28 U.S.C. § 1503, the Court of Claims has jurisdiction over a counterclaim by the Government based on the False Claims Acts, 31 U.S.C. §§ 231–35. Where a person avails himself of the privilege of suing the Government in the Court of Claims, he must do so subject to the conditions annexed by the Government to the exercise of the privilege.

Courts ⚷ 450

**Counterclaims; Court of Claims jurisdiction; scope of relief.**

[9] The purpose of the counterclaim jurisdiction provided by 28 U.S.C. § 1503 is to permit the Government, when sued in the Court of Claims, to have determined in a single suit all questions which involve mutual obligations between the Government and a claimant against it.

Courts ⚷ 450

**Fraud against the United States; False Claims Act; Housing & Urban Dev. area management contracts.**

[10] The False Claims Act, 31 U.S.C. §§ 231–35, which was intended without qualification to reach all types of fraud that might result in financial loss to the Government, applies to a situation where, contrary to regulations of the Department of Housing and Urban Development that require the area management broker to solicit at least three competitive bids for each item open for bid for renovation jobs, plaintiff knowingly conspired to receive all invitations to bid for each item; rigged the bidding in such a way that he obtained each contract, and thus prevented the requisite competition from other legitimate contractors.

United States ⚷ 120

**Judgments; former adjudication; criminal proceedings; effect of on later civil proceedings.**

[11] Since 18 U.S.C. § 1001 and 3 1U.S.C. § 231 both deal with similar activity—knowingly making and presenting a false claim to the Government—a criminal conviction under the former statute establishes civil liability for violations of the latter statute.

Judgment ⟹ 648

**Fraud against the United States; forfeiture provision of False Claims Act; damages.**

[12] Under the circumstances of this case, defendant is entitled to $2,000 for each purchase order forming the basis for plaintiff's criminal indictment and conviction, whether or not defendant can prove actual damages, and each purchase order is regarded as a separate claim for purposes of defendant's counterclaim.

United States ⟹ 120

**Damages; False Claims Act; burden of proof.**

[13] The amount of damages sustained by the Government in the instant case is the difference between the amount the Government actually paid in reliance on the false claims of plaintiff and the amount it would have paid had there been fair, open and competitive bidding. Under the False Claims Act, the Government has the burden of proving the amount of its losses.

United States ⟹ 120

**Pleading and practice; counterclaims; amendment of counterclaim; timeliness.**

[14] An attempt by defendant to add additional items to its counterclaim through a footnote in its post-argument brief to the court will not be countenanced. Where a case is to be remanded to the trial judge for further proceedings, the appropriate procedure if defendant wishes to amend its counterclaim is to file a timely motion for leave to do so with the trial judge.

Courts ⟹ 463

*Arnold B. Robbins*, attorney of record for plaintiff.

*Howard Slavit* and *Carolyn B. Lamm*, with whom was *Acting Assistant Attorney General Irving Jaffe*, for defendant.

Before COWEN, *Chief Judge*, MARKEY, *Chief Judge*,* and LARAMORE, *Senior Judge*.

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*Chief Judge of the United States Court of Customs and Patent Appeals, sitting by designation pursuant to 28 U.S.C. § 293(a).

COWEN, *Chief Judge*, delivered the opinion of the court:

This case, which arises out of plaintiff's involvement in a housing rehabilitation program conducted by the Department of Housing and Urban Development (HUD), comes before the court on defendant's motion for partial summary judgment as to plaintiff's petition and for summary judgment as to its own counterclaim.[1]

The facts in this case are not complicated. The Government, through HUD, owned during the relevant time period various properties which it had acquired through foreclosures and sales. As one would readily expect, these properties were often in dire need of repairs. To facilitate the quick disposition of the properties to private buyers, HUD entered into "Area Management Broker" (AMB) contracts with local real estate brokers, who then became agents of HUD in the repair and subsequent sale of the properties. For the repair and sale of certain of the properties in the Seattle, Washington, area, HUD entered into an AMB contract with Emil C. Gislason, d/b/a Berg Realty Company. Working for Mr. Gislason in this enterprise were Roy H. Christopherson and George J. Manus, both of whom play feature roles in the activities which form the basis of this litigation.

The AMB contract and the procedures used in carrying it out were governed by various HUD regulations and policies. The applicable regulations required Berg Realty Company to solicit at least three competitive bids for various jobs which were necessary for the renovation of the properties in question.[2] These tasks were classified separately according to the different craft skills that were required to complete them. No matter how many bids were received by the AMB, the applicable HUD policies prohibited any contractor from receiving more than one craft job on each FHA property. Pursuant to the langauge of the AMB contract, Berg Realty Company was authorized to "procure * * * such supplies, materials, equipment, and services * * * as may be necessary for the maintenance, repair, and operation of the project where the cost of a single item or total cost of a series of related items * * * does not exceed $2,500.00."[3] It was also the responsibility of the AMB, in this case Berg Realty Company, to accept and compile the various bids, complete certain portions of each purchase order, and then to forward the material to HUD's local office for further processing. After this processing was completed, several copies of the purchase orders were returned to the AMB in part so that its employees could certify the completion of the work by the private contractor.

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[1] In an effort to clarify an otherwise very confusing situation, defendant's post-argument brief requests the court "not [to] consider the final three contracts listed in claim 1 [sic] of plaintiff's petition (FHA No. 561-177215-203, P.O. 9829; FHA No. 561-206005-203, P.O. unlisted; and FHA No. 561-106587-203, P.O. 9871) to be a part of said motion." It appears that defendant's work product was "a committee effort," and we feel sure that the confusion resulted from the difficulties inherent in this method of production rather than a lack of care by the individuals involved.

[2] In this regard, Chapter 3 of HUD's Property Disposition Handbook states the following:

"Competition on small purchase transactions may be limited to three contractors or suppliers in the local trade area. Additional competition may be solicited if necessary to assure reasonable prices, and competition outside of the trade area should be solicited when necessary to accomplish that objective."

During this time, plaintiff, Horton J. Brown, was a general contractor doing business in the State of Washington. Between the latter part of 1970 and the spring of 1972, he worked on various properties in the Seattle area covered by HUD's AMB contract with Berg Realty Company. According to defendant, Mr. Brown entered into a conspiracy with various individuals to circumvent the regulations and policies discussed above. To ensure that he received every bid on the various properties involved in this renovation program, Mr. Brown allegedly made arrangements to receive all the invitations to bid for each item open for bid. In this manner, he could rig the bidding in such a way that he would always emerge the winner of the contract in question. In order to lend some semblance of propriety to this activity, Mr. Brown allegedly created the following "companies" solely for bidding purposes: B & B Construction Company, Horton Brown, Western Company, Horton J. Brown & Associates, Ray Browder, and Western Electrical & Mechanical System. According to defendant, Mr. Brown engaged in this activity with full knowledge that his actions would prevent the requisite competition from other legitimate contractors.

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[3] In actual practice, the ceiling was somewhat lower. According to Chapter such specific supported demonstration of factual Board error the Board's statement of facts will be accepted. *Jefferson Constr. Co.* v. *United States*, of a series of related items exceeds $2,000. * * *"

An essential part of the factual background of this case concerns the events which occurred when plaintiff's alleged "system" was uncovered during a lengthy investigation by the Federal Bureau of Investigation. Subsequent to the completion of this investigation, an indictment was filed by a grand jury formed in the Western District of Washington against plaintiff, Messrs. Browder, Gislason, Christopherson, and Manus. Plaintiff was named in 17 counts of the indictment, dated August 15, 1972, alleging various violations of Title 18, Section 1001 of the United States Code.[4] He was also named along with the other principals in the case in a conspiracy count based on Title 18, Section 371 of the United States Code.[5] The indictment covered some, but clearly not all, of the contracts between plaintiff and HUD. By the time the indictment was filed, HUD had approved many purchase orders in the names of plaintiff's various companies, and several of plaintiff's claims for payment had been paid by defendant in the normal course of business. However, when the local office of HUD learned of the FBI investigation and the indictment, it directed that no further payments be transferred to plaintiff pending the final outcome of the criminal proceedings.

On November 24, 1972, after a trial in which plaintiff testified, a jury found Mr. Brown guilty as charged on all 18 counts in which he was named in the indictment. Plaintiff was fined $5,000, sentenced to six months in jail, and placed on probation for two-and-a-half years. His conviction was affirmed by the Ninth Circuit Court of Appeals on August 17, 1973.

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[4] 18 U.S.C. § 1001 states that:

"Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully falsifies, conceals or covers up by any trick, scheme, or device a material fact, or makes any false, fictitious or fraudulent statements or representations, or makes or uses any false writing or document knowing the same to contain any false, fictitious or fraudulent statement or entry, shall be fined not more than $10,000 or imprisoned not more than five years, or both."

[5] 18 U.S.C. § 371 states in pertinent part:

"If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined not more than $10,000 or imprisoned not more than five years, or both."

On June 16, 1972, plaintiff, in his own right and as the alleged assignee of Ray Browder, filed his petition in this court, making numerous breach of contract claims and requesting damages totalling $64,794. On February 26, 1973, the Government commenced a civil action in the United States District Court for the Western District of Washington under the False Claims Act, 31 U.S.C. § 231–35, against plaintiff, Ray Browder, and the officials of the Berg Realty Company involved in the criminal proceedings. Defendant, on February 28, 1973, filed a motion in this court to stay the proceedings here pending the outcome of the District Court litigation. However, before a decision from this court could be made, the District Court, on motion from Mr. Brown, ordered that all proceedings in that forum as to Mr. Brown be stayed pending further order of that court. On May 15, 1973, a trial judge of our trial division denied defendant's motion to stay proceedings. His ruling was based in part on the fact that plaintiff had filed his suit here prior to the time defendant filed its complaint in the District Court.

## I

### *Assignment of Claims*

Our first task in this case is to determine precisely which claims found in plaintiff's petition are properly before the court. Paragraph three of plaintiff's petition states that "all rights of Ray Browder to payment or awards under any of the contracts or bids hereinbelow described have been assigned to plaintiff."[6] In determining whether these alleged assignments are valid, we look first to the Assignment of Claims Act, 31 U.S.C. § 203, 41 U.S.C. § 15, which sets forth in detail all the procedures which are required. The Act states in part that:

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[6] After a careful review of the evidence now in the record, we find that the following successful bids were placed in the name of Ray Browder: FHA No. 561–187323–221 (P.O. No. 10270); FHA No. 561–191409–203 (P.O. No. 10163); FHA No. 561–167731–221 (P.O. No. 10299); FHA No. 561–148884–203 (P.O. No. 10167). Defendant also claims that FHA No. 561–157591–203b2 ($1,983) was submitted in the name of Mr. Browder. However, since defendant's exhibits do not contain a copy of the specific Invitation to Bid signed by Mr. Browder, we have decided to leave this last contract off the list. No change in the final results should occur, though, in view of our decision as to plaintiff's claim three, discussed later in this opinion.

> All * * * assignments * * * of any claim upon the United States * * * shall be absolutely null and void, unless they are freely made and executed in the presence of at least two attesting witnesses, after the allowance of such a claim, the ascertainment of the amount due, and the issuing of a warrant for the payment thereof. [31 U.S.C. § 203]
>
> No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred so far as the United States are concerned. [41 U.S.C. § 15]

The Act, which is clearly applicable to the situation presently before the court, does contain exceptions to the general provisions cited above, to authorize assignments to "a bank trust company, or other financing institution, including any Federal lending agency." 31 U.S.C. § 203, 41 U.S.C. § 15.

At no place in his submissions to this court does plaintiff allege that he has complied with the Assignment of Claims Act. Indeed, plaintiff freely admits that at least a portion of the Act was not followed. *See Plaintiff's Brief in Opposition to Defendant's Motion for Summary Judgment*, at 3. This concession would seem to preclude the validity of the alleged assignments by Ray Browder to plaintiff. *See Uniroyal, Inc.* v. *United States*, 197 Ct. Cl. 258, 260–61, 454 F. 2d 1394, 1396 (1972); *Beaconwear Clothing Co.* v. *United States*, 174 Ct. Cl. 40, 49–51, 355 F. 2d 583, 589–90 (1966); *Royal Indemnity Co.* v. *United States*, 117 Ct. Cl. 736, 746, 93 F. Supp. 891, 894 (1950). In any event, since plaintiff clearly does not fall within the "financing institution" exception cited above and has not demonstrated compliance with the procedures mandated by this Act, the purported assignments are invalid, and we hold that plaintiff may not recover on any of the Browder claims assigned to plaintiff.

## II

### *Plaintiff's Claims 1 and 2*

Plaintiff's first substantive claim, labeled as "Express Contract," seeks recovery on 20 purchase orders which plaintiff allegedly submitted to defendant for payment and which were never paid. His second claim alleges that, although certain work was substantially completed, several purchase orders were not submitted to defendant, because of defendant's prior repudiation of the relevant contracts. These two claims will be treated together here because defendant's counter-argument applies to both claims collectively. Defendant contends that, based upon plaintiff's fraudulent activity and pursuant to applicable case law, HUD possessed the power to cancel *all* of the contracts listed in these claims. Therefore, according to defendant, no payments were due on these purchase orders and these claims should be dismissed.

If defendant is to win on its "cancellation" argument, it must demonstrate that plaintiff's activity as to each and every contract was fraudulent. *See United States* v. *Acme Process Equip. Co.*, 385 U.S. 138 (1966). Defendant's blanket assertion in this regard falls far short of a showing by undisputed facts that plaintiff obtained each of the contracts included in his claims 1 and 2 knowingly by false and fraudulent representations. Indeed, plaintiff denies that any such conduct existed as to *any* of these contracts. In an affidavit accompanying his brief to the court, Mr. Brown states that:

> At no time did I obtain nor have I attempted to obtain any remuneration or other consideration from the United States except for full and fair value rendered or to be rendered by me to the United States. Consequently, I deny that I have knowingly and intentionally practiced or attempted to practice fraud against the United States in the proof, statement, establishment or allowance of any of the claims set forth in my Petition.

In order to prevail on its motion for summary judgment, in which defendant contends that no material fact remains in dispute, defendant must demonstrate that plaintiff's affidavit cited above does not create an issue of fact that forces the entire "cancellation" question to trial. In other words, defendant must show the court why plaintiff is estopped from claiming that his prior activity in obtaining these contracts was entirely correct and "above-board."

Defendant's "estoppel" argument is based primarily on plaintiff's conviction of violating 18 U.S.C. § 1001 and 18 U.S.C. § 371. According to defendant, "[b]y virtue of the doctrine of collateral estoppel, plaintiff is estopped to deny any question of fact distinctly put in issue and directly determined by the district court as a ground for his conviction in the antecedent criminal action." *Defendant's Post-Argument Statement*, at 4–5. Defendant's argument follows that plaintiff is debarred from now asserting the lack of fraud in his prior bidding activities and cannot create a dispute of fact with respect to defendant's "cancellation" argument.

We agree with defendant's reasoning as it relates to those purchase orders in claims 1 and 2 of plaintiff's petition that also formed the basis of plaintiff's conviction.[7] It has been well established that prior criminal conviction may work an estoppel in a subsequent civil proceeding. *See Local 167, Int'l Bhd. of Teamsters* v. *United States*, 291 U.S. 293, 298 (1934); *Armstrong* v. *United States*, 173 Ct. Cl. 944, 968, 354 F. 2d 274, 290–91 (1965). Therefore, for those purchase orders listed in plaintiff's indictment and conviction, the question becomes simply whether cancellation is an appropriate sanction for contract activity violating 18 U.S.C. § 1001.

We are aided in this determination by several of the cases cited to us by defendant, especially *United States* v. *Acme Process Equip. Co.*, 385 U.S. 138 (1966). In *Acme* the Supreme Court was presented with the question whether the Government could legally cancel contracts found to have been obtained in a fraudulent manner pursuant to the Anti-Kickback Statute, 41 U.S.C. § 51 (1970).[8] Although this

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[7] Those purchase orders listed both in plaintiff's petition (claims 1 and 2) and in the earlier indictment are as follows: FHA No. 561–148884–203 (P.O. Nos. 10167, 10510, 10169, 10168); FHA No. 561–191409–203 (P.O. No. 10163).

[8] Actually, the defendants in Acme had never been found guilty of the crimes outlined in the original Anti-Kickback Act, 60 Stat. 37. However, in 1960 Congress amended the civil provisions of the Act to cover the type of contracts involved in defendant's situation. 74 Stat. 740. This amended provision was made retroactive to permit the Government to recover kickbacks "whether heretofore or hereafter paid or incurred. * * *."

Act contained express provisions for civil sanctions against anyone found guilty of fraudulent activity, the Supreme Court found that "[t]here [was] absolutely no indication in the legislative history of the * * * Act of Congress, in providing a civil remedy for a more tangible evil, intended to preclude other civil sanctions necessary to effectuate the purpose of the Act." 385 U.S. at 145. *See also United States* v. *Mississippi Valley Generating Co.*, 364 U.S. 520, 563 (1961). Similarly, in the situation presently before this court we have been cited to no authority which indicates that Congress did not intend to permit cancellation as an alternative remedy for contracts fraudulently obtained under 18 U.S.C. § 1001. Indeed, in studying the many pronouncements in prior cases regarding the purpose of this statute, it becomes very clear that cancellation for those contracts proven to be "tainted" is in order. *See United States* v. *Bedore*, 455 F. 2d 1109, 1111 (9th Cir. 1972); *Stein* v. *United States*, 363 F. 2d 587 (5th Cir.), *cert. denied*, 385 U.S. 934 (1966); *United States* v. *Johnson*, 284 F. Supp. 273, 278 (W.D. Mo. 1968), *aff'd* 410 F. 2d 38 (8th Cir.), *cert. denied*, 396 U.S. 822 (1969). Therefore, we conclude: (1) plaintiff is estopped from denying his fraudulent activity as to those contracts forming the basis for his conviction of violating 18 U.S.C. § 1001, and (2) defendant has the legal right to cancel contracts found to have been obtained in violation of 18 U.S.C. § 1001. From these conclusions it follows that, despite Mr. Brown's affidavit, defendant prevails in its motion for summary judgment as to those portions of plaintiff's claims 1 and 2 which were specifically included in plaintiff's criminal indictment and conviction.

However, we cannot grant defendant's motion for summary judgment as it relates to the remaining purchase orders included in plaintiff's first two claims. In its reply brief, defendant states that "upon examination of the other documents in [Exhibits] 12, 15 and 17, the Court will be thoroughly convinced that all of the items in [Claims 1 and 2] reek of fraud * * *" *Defendant's Reply Brief*, at 21. However, collateral estoppel does not apply to those purchase orders which did not form the basis of plaintiff's conviction. As the Supreme Court stated in *Emich Motors Corp.* v. *General Motors Corp.*, 340 U.S. 558, 569 (1951):

> Such estoppel extends only to questions "distinctly put in issue and directly determined" in the criminal prosecution. In the case of a criminal conviction based on a jury verdict of guilty, issues which were essential to the verdict must be regarded as having been determined by the judgment. [citations omitted]

No matter how broad we might believe to be the scope of the conspiracy in which plaintiff was involved, the criminal conviction can be utilized to estop plaintiff only as to the fraudulent acts for which he was convicted.[9] Therefore, we must recognize plaintiff's affidavit as creating an issue of fact as to the remaining purchase orders and remand this portion of plaintiff's claims 1 and 2 for trial.[10]

## III

### *Plaintiff's Claim 3*

In his third claim plaintiff seeks recovery of $8,748 for emergency work which he allegedly performed pursuant to oral instructions from one of defendant's agents. Defendant counters that even if these instructions were given, plaintiff's claim should fail, since the instructions were completely unauthorized. After a review of the record before us, we conclude that defendant's motion for summary judgment should be granted as to plaintiff's claim 3.

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[9] Defendant also argues that the court should recognize collateral estoppel as affecting all of the purchase orders in these claims because "the United States Attorney might have elected to prosecute the plaintiff on all of the contracts listed in his petition but instead chose to indict him on only 18 counts." This argument is not persuasive, since one can make the equally forceful counter-argument that any omissions by the prosecutor resulted from either weak or non-existent proof of plaintiff's fraudulent activity.

[10] Our rationale extends also to defendant's alternative argument for cancellation, found in its reply brief, which claims that plaintiff "successfully obtained those contracts listed in petition Claims 1 and 2 by circumventing and violating the applicable HUD regulations." *Defendant's Reply Brief*, at 8 (footnote 3). Issues of fact also remain here as to those purchase orders not directly at issue in plaintiff's criminal trial.

Defendant's argument is supported by settled principles of law. In a previous decision involving substantially similar actions of HUD officials, the court stated:

> It is evident that neither of these HUD officials was a contracting officer nor authorized to commit defendant to any financial obligations of a contractual nature directly with private parties. The United States is not bound by the unauthorized acts of its agents. Here, assuming that plaintiff's recollection of events is correct, [plaintiff] has not shown that [the agents] acted within their authority. It is plaintiff's responsibility to make such a showing and plaintiff is deemed to have notice of their limited authority. *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947); *National Bank of N. America* v. *United States*, 197 Ct. Cl. 948, 456 F. 2d 754 (1972); *California-Pac. Util. Co.* v. *United States*, 194 Ct. Cl. 703 (1971); *Fountain* v. *United States*, 192 Ct. Cl. 495, 427 F. 2d 759 (1970), *cert. denied*, 404 U.S. 839 (1971); *Miami Metropolitan Bldg. Corp.* v. *United States*, 180 Ct. Cl. 503 (1967).

*Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 711–12, 468 F. 2d 922, 925 (1972); *see Putnam Mills Corp.* v. *United States*, 202 Ct. Cl. 1, 479 F. 2d 1334 (1973).[11]

Therefore, the primary question is whether the evidence presented to the court demonstrates that the alleged instructions, if given, were "authorized" by defendant. From the record, we have determined that such instructions as described in plaintiff's third claim would clearly have been unauthorized and therefore that plaintiff's claim must fail. First, such an instruction would have been in direct contravention of the AMB contract between HUD and Berg Realty Company, which authorized the latter to procure supplies, equipment and services only if their cost did not exceed $2,500. The purchase orders involved in this claim show a total cost for the related items involved of $8,748, an amount far in excess of the $2,500 ceiling. Furthermore the contract mandates that, if it becomes necessary to purchase services in an amount in excess of $2,500, "the Contractor [Berg Realty Company] will refer [the negotiations] to the Government." This reference must be in writing and must be made before the time the services are needed, so as to allow the Government ample opportunity either to enter into the suggested agreement or to obtain the services from an alternative source. Since plaintiff makes no allegation that these provisions were followed, it becomes apparent that the alleged instructions by defendant's agent would have run counter to the provisions of the AMB contract.

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[11] The court in *Putnam Mills Corp.* summarized this theory when it held that "representations or agreements made by an agent of the Government in his representative capacity will not necessarily bind the United States if such an agreement is beyond the agent's authority. In addition, the Government is not estopped from later denying the agent's lack of authority. 202 Ct. Cl. at 9, 479 F. 2d at 1338. [Citations omitted]

The instructions would have also been in direct conflict with the applicable HUD regulations. Chapter 8–2 of the Property Disposition Handbook requires that purchase orders and payment authorizations be used "in connection with each purchase of supplies, materials, equipment, and services. * * *" After substantial completion by the AMB, the pertinent Government form was to be forwarded to HUD officials, where proper purchase order numbers were to be inserted. The absence of any purchase order numbers on these purchase orders demonstrates a clear instance of noncompliance with the applicable regulations. This fact, combined with the showing that specific contract provisions did not authorize such instructions, compels the conclusion that the alleged actions by defendant's agent were unauthorized and conferred on plaintiff no right to recover.

## IV

### *Plaintiff's Claim 4*

Finally, plaintiff claims that he was not awarded 11 contracts for which he was the low bidder. According to plaintiff, in failing to award this work to plaintiff, defendant violated the provisions of 41 C.F.R. §§ 1–1.1202(d) and 1–1.1204–1(b), which require the Government to execute and file a "Determination of Non-responsibility" to unsuccessful bidders in plaintiff's position. As a result of this alleged violation of the pertinent regulations, plaintiff seeks recovery of lost profits totalling $6,110. Plaintiff's claim must be denied, since, regardless of the reasons for defendant's failure to award the contracts to plaintiff, he cannot recover lost profits. As we stated in *Keco Industries, Inc.* v. *United States*, 192 Ct. Cl. 773, 784, 428 F. 2d 1233, 1240 (1970):

> One other point which should be disposed of at this time concerns the question of damages. Plaintiff claims that it is entitled to recover * * * lost profits. We find, however, that it would be improper for this court to award plaintiff lost profits since the contract under which plaintiff would have made such profits never actually came into existence. *Heyer Prods. Co.* v. *United States*, 135 Ct. Cl. 63, 69, 140 F. Supp. 409, 412 (1956).

*See McCarty Corp.* v. *United States*, 204 Ct. Cl. 768, 499 F. 2d 633 (1974); *Excavation Constr., Inc.* v. *United States*, 204 Ct. Cl. 299, 494 F. 2d 1289 (1974). Therefore, we grant defendant's motion for summary judgment as it relates to plaintiff's fourth claim and hold that plaintiff is not entitled as a matter of law to recover.[12]

## V

### *Defendant's Counterclaim*

*Jurisdiction.* Defendant seeks partial summary judgment on its counterclaim for damages pursuant to the False Claims Act, 31 U.S.C. §§ 231–35 (1970). Before reaching the merits of defendant's argument, we consider plaintiff's contention that this court lacks jurisdiction to hear a counterclaim asserted by the Government under the False Claims Act. In this regard, plaintiff refers us to 31 U.S.C. § 232(A), which provides (regarding False Claims Act violations):

> The several district courts of the United States, the several district courts of the Territories of the United States within whose jurisdictional limits the person doing or committing such act shall be found, shall wheresoever such act may have been done or committed, have full power and jurisdiction to hear, try, and determine such suit.

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[12] In view of our conclusions as to the merits of plaintiff's various claims before this court, we need not discuss in detail the validity of defendant's alternative contention, that all of plaintiff's claims should be forfeited pursuant to 28 U.S.C. § 2514. However, it should be noted that, even at its best, this argument would, following our collateral estoppel discussion, *supra*, affect only those contracts which formed the basis of plaintiff's prior conviction.

Relying on this language, plaintiff contends that "the United States Court of Claims is * * * without jurisdiction to entertain defendant's counterclaim for money damages under [31 U.S.C. §§ 231–35.]"

We disagree with plaintiff and conclude that the court does have jurisdiction over a counterclaim by the Government based on the False Claims Act. The jurisdictional issue presently before us is controlled by 28 U.S.C. § 1503, which provides that:

> The Court of Claims shall have jurisdiction to render judgment upon any *set-off* or demand by the United States against *any* plaintiff in such court.

Prior case law demonstrates that Section 1503 prevails in situations such as this one and, therefore, that defendant should be allowed an opportunity to have its counterclaim adjudicated in this forum. In an early decision regarding the jurisdiction of this court, the Supreme Court explained the intent and scope of Section 1503 as follows:

> [Suits against the government in the Court of Claims] are not suits at common law within its true meaning. The government cannot be sued, except with its own consent. It can declare in what court it may be sued, and prescribe the forms of pleading and the rules of practice to be observed in such suits. It may restrict the jurisdiction of the court to a consideration of only certain classes of claims against the United States. Congress, by the act in question, informs the claimant that if he avails himself of the privilege of suing the government in the special court organized for that purpose, he may be met with a set-off, counter-claim, or other demand of the government, upon which judgment may go against him, without the intervention of a jury, if the court, upon the whole case, is of opinion that the government is entitled to such judgment. If the claimant avails himself of the privilege thus granted, he must do so subject to the conditions annexed by the government to the exercise of the privilege.

*McElrath* v. *United States*, 102 U.S. 426, 440 (1880). More recently, when confronted with a similar jurisdictional question in *Cherry Cotton Mills, Inc.* v. *United States*, 327 U.S. 536, 539 (1946), the Supreme Court concluded that the purpose of the counterclaim jurisdiction was

> * * * to permit the Government, when sued in the Court of Claims, to have determined in a single suit all questions which involved mutual obligations between the Government and a claimant against it. Legislation of this kind has long been favored and encouraged because of a belief that it accomplishes among other things such useful purposes as avoidance of "circuity of action, inconvenience, expense, consumption of the courts' time, and injustice." *Chicago & N.W.R. Co.* v. *Lindell*, 281 U.S. 14, 17 and cases cited.

We have found no cases that discuss in detail the precise jurisdictional issue presently confronting us, *i.e.*, whether the court has jurisdiction over a Government counterclaim based on the False Claims Act. However, the court has determined the merits of False Claims Act counterclaims on numerous occasions without questioning the court's jurisdiction to hear the issue. *See, e.g.*, *Eastern School* v. *United States*, 180 Ct. Cl. 676, 381 F. 2d 421 (1967); *Acme Process Equip. Co.* v. *United States*, 171 Ct. Cl. 324, 350–55, 347 F. 2d 509, 524–28 (1965), *rev'd on other grounds*, 385 U.S. 138 (1966), *reh. denied*, 385 U.S. 1032 (1967); *Klein* v. *United States*, 152 Ct. Cl. 8, 285 F. 2d 778 (1961); *Wagner Iron Works* v. *United States*, 146 Ct. Cl. 334, 174 F. Supp. 956 (1959); *Little* v. *United States*, 138 Ct. Cl. 773, 152 F. Supp. 84 (1957). Furthermore, there is one prior decision of the court concerning a somewhat similar matter which aids us in our present determination. In *Erie Basin Metal Prods., Inc.* v. *United States*, 123 Ct. Cl. 433, 107 F. Supp. 588 (1952), the court was presented with a jurisdictional question regarding the Contract Settlement Act, 41 U.S.C. § 119, which has the following jurisdictional language similar to that found in the False Claims Act:

> The several district courts of the United States, the District of Columbia, the several district courts of the Territories of the United States, within whose jurisdictional limits the person, or persons, doing or committing such act, or any one of them, resides or shall be found, shall wheresoever such act may have been done or committed, have full power and jurisdiction to hear, try, and determine such suit. * * *

In discussing its jurisdiction to hear the Government's counterclaim, the court reasoned that, although as plaintiff, the Government, could bring suit only in the proper District Court, "it does not follow that in an action initiated by a contractor against the United States, the Government cannot [assert] the rights given it by this Act in a counterclaim in this court." 123 Ct. Cl. at 436, 107 F. Supp. at 589–90. Speaking of 28 U.S.C. § 1503, the court stated that "[u]nder this section, defendant can assert in this court any right it has against the plaintiffs suing it here, which includes, of course, rights given it by the Contract Settlement Act; and this court, under section 1503 of 28 U.S.C. is empowered to render judgment thereon." 123 Ct. Cl. at 437, 107 F. Supp. at 590. Thus, there is no doubt that our jurisdiction extends to defendant's False Claims Act counterclaim.[13]

*Merits of Defendant's Counterclaim.* Having determined that the court has jurisdiction over defendant's counterclaim, we must consider whether the Government should prevail on its partial summary judgment motion as to this issue. The False Claims Act provides in part that:

> Any person not in the military or naval forces of the United States, or in the militia called into or actually employed in the service of the United States, who shall make or cause to be made, or present or cause to be presented, for payment or approval, to or by any person or officer in the civil, military, or naval service of the United States, any claim upon or against the Government of the United States, or any department or officer thereof, knowing such claim to be false, fictitious, or fraudulent, or who, for the purpose of obtaining or aiding to obtain the payment or approval of such claim, makes, uses, or causes to be made or used, any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry * * * shall forfeit and pay to the United States the sum of $2,000, and, in addition, double the amount of damages which the United States may have sustained by reason of the doing

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[13] We note in passing the interesting turnabout by plaintiff on this issue. In his motion to stay the proceedings of the District Court, he argued that "[the Government's] second claim herein duplicates [its] counterclaim in the United States Court of Claims cause, and there appears to be no reason to vary from the rule of comity that the court first obtaining jurisdiction over the subject matter should retain same until a final judgment is entered." Since we have held against plaintiff's jurisdictional argument on its merits, we need not discuss whether plaintiff was actually estopped to deny the jurisdiction of the Court of Claims because of his earlier arguments to the District Court.

> or committing such act, together with the costs of suit; and such forfeiture and damages shall be sued for in the same suit.

31 U.S.C. § 231 (1970). It is clear that this statutory language covers conduct as alleged in defendant's counterclaim. In *United States* v. *Neifert-White*, 390 U.S. 228 (1968), the Supreme Court found that "the Act was intended to reach all types of fraud without qualification, that might result in financial loss to the Government." 390 U.S. at 232. The Third Circuit, in *United States* v. *Rohleder*, 157 F. 2d 126 (3rd Cir. 1946), found the False Claims Act applicable to a factual situation similar to the one presently before the court.[14]

However, our determination that the False Claims Act is applicable to the activity alleged in defendant's counterclaim does not translate into a total victory for defendant on its motion for partial summary judgment. We are again confronted with problems of outstanding disputes of material fact regarding plaintiff's bidding activities. Unless the uncontroverted facts establish that plaintiff committed the illegal acts described in 31 U.S.C. § 231 with respect to each purchase order sued upon, defendant cannot prevail on its motion for partial summary judgment on the counterclaim. Since 18 U.S.C. § 1001 and 31 U.S.C. § 231 both deal with similar activity—knowingly making and presenting a false claim to the Government—a criminal conviction under the former statute has been held to establish civil liability for violations of the latter statute. *See United States* v. *Greenberg*, 237 F. Supp. 439 (S.D.N.Y. 1965); *United States* v. *Levinson*, 369 F. Supp. 575 (E.D. Mich. 1973). It follows that plaintiff is estopped from denying in this civil litigation those facts regarding his activities established by the jury verdict against him in the earlier criminal proceeding.[15] As previously stated, however, collateral estoppel does not apply to those purchase orders which did not form the basis of plaintiff's conviction, and Mr. Brown's affidavit creates an issue of fact which must be remanded for trial. In summary, we grant defendant's motion for partial summary judgment on its counterclaim only to the extent of the purchase orders included in the criminal indictment upon which plaintiff was convicted.

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[14] In *Rohleder*, the defendant submitted bids to obtain numerous purchase orders. As in the present situation, three bids were required for each purchase order, one or more of which defendant knew were false and fictitious.

[15] The following contracts are listed both in plaintiff's indictment and in defendant's counterclaim: FHA No. 561-137532-203 (P.O. No. 8463); FHA No. 561-149642-203 (P.O. No. 7688); FHA No. 561-152319-221 (P.O. Nos. 7085, 7083, 7084); FHA No. 561-158795-203 (P.O. No. 9107); FHA No. 561-168730-203 (P.O. No. 8025); FHA No. 561-176048-221 (P.O. No. 8495);

*Extent of Damages.* Our final task in this case is to determine the extent of damages defendant is now entitled to recover and what issues remain for trial. As quoted above, the False Claims Act provides for a forfeiture of $2,000, plus twice the amount of damages actually sustained by the United States for each false claim. *See* 31 U.S.C. § 231 (1970). Following the unambiguous language of the statute and the prior case law in this area, we have no difficulty in finding that defendant is entitled to $2,000 for each purchase order for which its partial summary judgment motion has been granted. The total forfeiture for these 14 purchase orders which are listed in footnote 15, *supra*, is, therefore, $28,000 to be paid whether or not defendant can prove actual damages. Plaintiff's argument that "[t]he $2,000.00 penalty is to be levied only against each 'project' and not against every purchase order issued," is simply not persuasive. Plaintiff was paid by HUD, not for each house he worked on, but for each purchase order submitted for processing. Therefore, each purchase order must be regarded as a separate claim for purposes of defendant's counterclaim. *See United States* v. *Ueber*, 299 F. 2d 310 (6th Cir. 1962); *United States* v. *Collyer Insulated Wire Co.*, 94 F. Supp. 493 (D.R.I. 1950). This result also makes a good deal of common sense, since it was only through plaintiff's fraudulent conduct that he was able to receive the awards to work on an entire "project" or house. Certainly, we should not allow plaintiff to utilize his fraudulent acts for the purpose of reducing the amount of forfeitures due on defendant's counterclaim.

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FHA No. 561-181095-203 (P.O. No. 9606); FHA No. 561-214478-203 (P.O. No. 6230); FHA No. 561-148884-203 (P.O. Nos. 10510, 10169, 10168); FHA No. 561-191409-203 (P.O. No. 10163). (It should be noted that this listing relies on defendant's brief for the purchasee order numbers, since no such information is found on the face of plaintiff's indictment.)

However, we cannot now determine precisely the amount of damages sustained by the Government. The parties agree that the applicable rule of law for computing the damage figure is the difference between the amount the Government actually paid in reliance on the false claims and the amount it would have paid had there been fair, open and competitive bidding. *See United States* v. *American Precisions Prods.*, 115 F. Supp. 823 (D.N.J. 1953). Defendant, however claims that in this instance "the only way to determine the amount of such excess * * * is to take the difference between the amount paid out by the Government and the actual cost of performance to the successful bidder." *Defendant's Initial Brief*, at 43–44. Defendant's assertion in this regard runs counter to the express language of the False Claims Act. Under the Act, the defendant has the burden to prove what amount it lost as a result of plaintiff's fraudulent acts. It must certainly do more than submit a schedule of the costs of performance. A trial is necessary on this issue, especially since plaintiff argues that industry-wide profit figures will demonstrate that his profit margin was neither "unusual nor excessive." *Plaintiff's Response to Defendant's Post-Argument Statement*, at 4.[16]

## VI

### *Conclusion*

For the reasons stated above, this case is remanded to the trial division for further proceedings in accordance with this opinion. Entry of judgment dismissing certain of plaintiff's claims on which we have held he is not entitled to recover will be deferred, pursuant to Rule 102(d), pending final disposition of the remaining issues remanded for trial.

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[16] The discussion regarding defendant's False Claims Act counterclaim deals, of course, only with those purchase orders listed in Defendant's Amended Counterclaim, filed on June 29, 1973. Although it is difficult to believe, defendant seemingly attempts to add five more items to its counterclaim through a footnote in its post-argument brief to the court. *See Defendant's Post-Argument Statement,* at 4 (footnote 1). Of course, this tactic is highly irregular, and we do not recognize those items as part of defendant's counterclaim at this time. If defendant wishes to amend its counterclaim a second time, it may, within 30 days from the issuance of this opinion, file a motion for leave to do so with the trial judge.

525 F. 2d 1367

# WESTWOOD CHEMICAL, INC. AND EASTWOOD CHEMICAL INC. v. THE UNITED STATES

[No. 473-69. Decided October 22, 1975]

ON THE PROOFS

**Patents; estoppel; prior adjudication of invalidity; obviousness.**—In the petition, as amended, plaintiffs allege infringement by defendant of specified claims (previously nonlitigated) of U.S. patents 2,742,378 and 2,841,566 relating to improvements in the manufacture of composite articles composed of *in situ*-formed resinous polymers and fibers, fillers, pigments or other suitable substrates to provide a material useful as boat hulls, airplane components, auto and truck bodies, etc. In *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, 445 F. 2d 911 (1971), the Sixth Circuit affirmed the lower court's holding of invalidity of the patents but only with respect to the particular claims there in issue and expressly restricted its opinion to the obviousness determination. These patents have also been involved in other patent litigation subsequent to *Owens-Corning* wherein estoppel was applied under the rationale of *Blonder-Tongue Labs., Inc.* v. *University of Illinois Foundation*, 402 U.S. 313 (1971). Defendant here has asserted collateral estoppel under *Blonder-Tongue*, and plaintiffs assert, *inter alia*, that they did not receive a full and fair opportunity to litigate the issue of validity in that the courts wholly failed to grasp the technical subject matter. It is *held* (1) that collateral estoppel may apply to nonlitigated claims—it is the issues litigated, not the specific claims around which the issues were framed that is determinative; (2) that despite the courts' failure to understand in part the technical subject matter, and since plaintiffs have not been able to show that the reviewing courts *wholly* failed to grasp the technical subject matter and issues, the errors are not sufficient to avoid application of estoppel; (3) that the differences between the prior art and the nonlitigated claims are not distinguishable from the differences between the prior art and the previously litigated claims; and (4) that the estoppel arising from the *Owens-Corning* case should extend to all of the claims here in issue. Plaintiffs are not entitled to recover and the petition is dismissed.

**Patents; estoppel; prior adjudication of invalidity; parties.**

[1] In a patent infringement action, to the extent that collateral estoppel is applicable, it is applicable also to the successor in interest of the patent.

Patents ⚿ 327(14)

**Patents; claims; construing and interpreting; generally.**

[2] It is well-established in the patent law that each claim of a patent is to be considered as setting forth a complete and independent invention.

Patents ⚷ 165(1)

**Patents; estoppel; prior adjudication of invalidity.**

[3] In patent infringement proceedings, a rule that would limit application of an estoppel only to specific claims is too mechanical, ignores the practicalities of patent practice, and could well lend itself to abuse. It is the issues litigated, not the specific claims around which the issues were framed, that is determinative, and thus collateral estoppel may apply to nonlitigated claims.

Patents ⚷ 327(3)

**Patents; estoppel; prior adjudication of invalidity.**

[4] Each court in which estoppel is asserted in patent infringement proceedings should satisfy itself that the estoppel is properly applied. As observed in *Blonder-Tongue Labs, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313, 314 (1971), application of the estoppel is not an automatic matter and the ultimate test of whether the estoppel is to be applied necessarily rests "on the trial courts' sense of justice and equity."

Patents ⚷ 327(1)

**Judgments; former adjudications; comity.**

[5] The principle of comity dictates that deference be paid to judgments of other coordinate tribunals, a prior adjudication of patent invalidity being entitled to substantial weight on all common questions.

Patents ⚷ 327(17)

**Patents; estoppel; prior adjudication of invalidity.**

[6] While a correct understanding of the technology of the patent involved in infringement proceedings and of the technology of the prior art is necessary to a proper resolution of the defense of obviousness, the demonstrated failure of a prior court properly to assess the technical implications of some *part* of the prior art will not support the conclusion that the court *wholly* failed to grasp the technical subject matter in issue.

Patents ⚷ 327(14)

**Court of Claims jurisdiction; generally.**

[7] Absent appeal from an adverse decision in prior infringement proceedings on the ground of the court's failure properly to assess the technical implication of some part of the prior art, this court cannot, and will not, in a subsequent action alleging infringement by the Government of the same patent, presume to act as an appellate forum to correct errors which could have been raised on appeal.

Patents ⚷ 327(14)

**Patents; estoppel; prior adjudication of invalidity.**

**[8] Even if the charge that the lower court in a patent infringement action failed properly to assess the technical implications of some part of the prior art were asserted on appeal and the appellate court failed to recognize the validity of the patentee's contention, application of the defense of estoppel raised in this court is not avoided unless it is also shown that the reviewing court *wholly* failed to grasp the technical subject matter and issues.**

Patents 🔑 327(13)

**Patents; estoppel; prior adjudication of invalidity.**

**[9] The correctness of an earlier decision declaring a patent invalid is not an issue in and is not a prerequisite to the application of the defense of estoppel.**

Patents 🔑 327(1)

**Patents; infringement; prior adjudication of invalidity.**

**[10] Where obviousness was the basis for the prior invalidity holding, inquiry by the subsequent court, as a prerequisite to application of the estoppel, should be whether the nonlitigated claims present new issues as to the art pertinent to the nonlitigated claims, as to the scope and content of that art, as to the differences between the prior art and the nonlitigated claims, and as to the level of ordinary skill in that art, within the mandate of *Graham* v. *John Deere Co.*, 383 U.S. 1, 17 (1966), and if the inquiries fail to raise any new triable issues, the obviousness determination in the prior proceeding should be equally applicable to the nonlitigated claims. If a comparison of the litigated and nonlitigated claims reveals differences of a substantive nature, it will be necessary for the subsequent court to determine whether the differences are of a kind that would have been itemized in a *Graham* analysis as a difference between the claim and the prior art, or whether it was known in the prior art and is only a part of the claimed combination as a whole that provides the context in which the obviousness determination is made. If it is only of the latter character, i.e. it is known in the prior art and does not alter the issue as to the differences between the claimed subject matter and the prior art, it is still necessary to assess the importance of the difference to the combination as a whole since it is from that standpoint that the obviousness determination must be made.**

Patents 🔑 327(13)

**Patents; claims; construing and interpreting; generally.**

**[11] It is appropriate to look to the specification to understand the meaning of a claim.**

Patents 🔑 267(1)

**Patents; estoppel; prior adjudication of invalidity; obviousness.**

**[12] Where a nonlitigated claim and a previously litigated claim which was held invalid for obviousness present the same differences**

from the prior art, in essentially the same combination, there is no substantive reason for relitigating the issue of obviousness of those differences, and the defense of estoppel should apply to the nonlitigated claim.

Patents ⚷ 327(13)

**Patents; patentability; commercial success.**

[13] Commercial success predicated on commercial practice which is different from the claimed process, is of little significance.

Patents ⚷ 36.2(1)

**Patents; validity; generally.**

[14] Advantages not set forth in the specification are of little weight in assessing the validity of an invention.

Patents ⚷ 167(1¾)

**Patents; patentability; genus and species.**

[15] Where a claim to the genus has been held invalid on the basis of the teaching of the species in the prior art, it follows that a claim to the species can raise no new issues.

Patents ⚷ 327(1)

**Patents; estoppel; prior adjudication of invalidity; process and product categories.**

[16] While processes and products are separate categories of invention, 35 U.S.C. § 101, it is not inconsistent to state that a process and product may present identical issues concerning, e.g., their obviousness, and this distinction, without more, is of no merit and does not defeat application of estoppel.

Patents ⚷ 327(1)

**Patents; estoppel; prior adjudication of invalidity; relitigation; avoidance of.**

[17] The rule in *Blonder-Tongue Labs., Inc.* v. *University of Illinois Foundation*, 402 U.S. 313, 314 (1971), was expressly intended to avoid relitigation of an issue resolved in prior infringement proceedings.

Patents ⚷ 327(1)

*T. A. TeGrotenhuis*, attorney of record, for plaintiffs. *Marshall I. Nurenberg*, of counsel.

*Thomas J. Byrnes*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

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Before COWEN, *Chief Judge*, NICHOLS and BENNETT, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed August 22, 1975, requesting that the court adopt the recommended decision of Trial Judge Hal D. Cooper, filed June 19, 1975, pursuant to Rules 54 and 55, as the basis for its judgment in this case since plaintiff has filed no request for review by the court within the time set by the Rules therefor and such time has expired. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the recommended decision as the basis for its judgment in this case. Therefore, defendant's motion of August 22, 1975, is granted, the court concludes that plaintiffs are not entitled to recover and their petition is dismissed.

## OPINION OF TRIAL JUDGE

COOPER, *Trial Judge:* For the second time in this case,[1] defendant seeks application of the collateral estoppel of *Blonder-Tongue Laboratories, Inc.* v. *University of Illinois Foundation*, 402 U.S. 313 (1971), this time to foreclose any recovery by plaintiffs on any of the remaining claims in the two patents in suit. In so doing, defendant relies on the prior decisions in *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, 317 F. Supp. 201 (N.D. Ohio 1970), *modified and aff'd*, 445 F. 2d 911 (6th Cir. 1971), *cert. denied*, 405 U.S. 917 (1972); *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 380 F. Supp. 517 (N.D. Ohio 1973), *aff'd*, 498 F. 2d 1115 (6th Cir. 1974); and *PPG Industries, Inc.* v. *Westwood Chemical, Inc.*, Civil Action No. C–71–49 (N.D. Ohio, Mar. 17, 1975) (unreported).[2]

After conducting a hearing and extended consideration of the questions presented, it has been concluded that the collateral estoppel doctrine, as set out in *Blonder-Tongue*, does apply to the claims here in issue, particularly in light of the

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[1] As discussed, *infra*, defendant's first motion for partial summary judgment was granted as to some of the claims, on the basis of collateral estoppel, on March 12, 1973.

[2] Still another case, *Westwood Chemical, Inc.* v. *Johns-Manville Fiber Glass, Inc.*, 477 F. 2d 1160 (6th Cir. 1973), dealt with the same patents but is not pertinent to the issues presented here. In all, these patents have been asserted, unsuccessfully, against seven defendants, Certain-Teed Products Corp., Union-Carbide Corp., Dow-Corning Corp., Ferro Corp., Molded Fiber Glass Body Co., Owens-Corning Fiberglas Corp., and Johns-Manville Fiber Glass, Inc.

*Owens-Corning* decision, and that defendant is entitled to a judgment in its favor.

## I.

United States Letters Patent No. 2,742,378 (hereafter the '378 patent), entitled "Fillers Having Vinyl Siloxane Groups Bonded to the Surface Thereof and Copolymers Thereof with Ethylenically Unsaturated Polymerizable Monomers," issued on April 17, 1956, to T. A. TeGrotenhuis on application serial No. 302,415, filed on August 2, 1952.[3] United States Letters Patent No. 2,841,566 (hereafter the '566 patent), entitled "High Polymers with Chemically Bonded Reinforcing and Method of Making Same," issued on July 1, 1958, to T. A. TeGrotenhuis on an application serial No. 439,463, filed on June 25, 1954.[4]

Both patents relate to improvements in the manufacture of composite articles composed of *in situ*-formed resinous polymers and fibers, fillers, pigments, or other suitable substrates. An olefinic resin-forming liquid, for example, a liquid mixture of styrene and an olefinically unsaturated polyester, is polymerized to the solid state while in contact with the substrate. The selection of a suitable treated substrate, such as fiberglass, used in combination with an *in situ*-formed resinous polymer, will provide a reinforced composite useful, for example, as boat hulls, airplane components, auto and truck bodies, etc.

To form the composite, the substrate is first reacted with a coupling agent which may be the hydrolysis product of a vinyl silane (the '378 patent) or an alkenyl silane such as allyl silane (the '566 patent) to chemically bond siloxane groups of the coupling agent to the substrate by a condensation-type of reaction through one or more silicon-oxygen linkages. An olefinic resin-forming liquid is then polymerized to the solid state in the presence of the treated substrate and a chemical bond is simultaneously formed between the olefinically unsaturated groups attached to the substrate and the olefinic groups in the resin-forming liquid. This latter bonding is by an addition-type of reaction wherein a chemical bond is formed between the vinyl groups attached to the substrate and the unsaturated groups, the carbon-to-carbon double bond groups, of the liquid resin.

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[3] This application was a continuation-in-part of application serial No. 251,157, filed October 12, 1951, and of application serial No. 243,737, filed August 25, 1951, and of application serial No. 585,824, filed March 30, 1945.

[4] This application was a division of serial No. 302,415 which issued as the '378 patent and was a continuation-in-part of the same parent applications from which the '378 patent originated.

It is apparent, both from the disclosure of the patents and from the testimony of the patentee, that the essence of the invention is the chemical bonding between a substrate treated with a siloxane coupling agent (either vinyl or allyl) and a liquid such as a polymerizable olefinic monomer by means of an addition-type of reaction. The resulting article thus consists of the resin, the siloxane coupling agent, and the substrate, all chemically bonded together to form a composite article having superior strength and water resistance.

## II.

The present action was brought by Westwood Chemical, Inc.,[5] on November 10, 1969, alleging infringment by defendant of claims 1, 3–6, 8–11, and 15–23 of the '378 patent, and claim 8 of the '566 patent.[6]

On July 29, 1970, the District Court for the Northern District of Ohio, per Judge Connell, held both the '378 and the '566 patents invalid under, *inter alia*, 35 U.S.C. § 102(a), (f), (g), and § 103, and further held that the defendant, Owens-Corning Fiberglas Corporation, did not infringe either of the patents. *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, 317 F. Supp. 201 (N.D. Ohio 1970) (hereafter the OCF case). On appeal, the Sixth Circuit affirmed on the basis of 35 U.S.C. § 103 but only with respect to the particular claims in issue, *i.e.*, claims 1, 3, 4, 6–8, 11, 14–19, 21, 23–26, and 28 of the '378 patent and claim 8 of the '566 patent. *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, 445 F. 2d 911 (6th Cir. 1971), *cert. denied*, 405 U.S. 917 (1972) (hereafter the OCF appeal). In so holding, the court expressly restricted its opinion to the obviousness determination, declining to express any view as to the other grounds of invadility found by Judge Connell. It did express doubt that one of the patents, Steinman Patent No. 2,563,288, on which the District Court relied, was properly viewed as prior art and accepted, *arguendo*, the contention that another of the patents was not prior art. However, on the basis of the seven other prior art references cited by the District Court, it affirmed the holding of obviousness and expressly rejected plaintiff's contention that it was denied a fair trial.

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[5] The patents were assigned in August 1971 to Eastwood Chemical, Inc., which was thereafter made a party to this action. It is clear that, to the extent collateral estoppel is applicable, it is applicable also to Eastwood as a successor in interest to the patents. *Lucerne Products, Inc.* v. *Cutler-Hammer, Inc.*, 175 USPQ 485 (N.D. Ohio 1972).

[6] The '378 patent contains a total of 28 claims while 14 claims appear in the '566 patent.

Relying on the judgment in the OCF case, defendant here moved for partial summary judgment, asserting collateral estoppel under *Blonder-Tongue* as to those claims that were held invalid in OCF. In opposition, plaintiffs asserted they had not received a full and fair opportunity to litigate the issue of validity in the OCF case; that Judge Connell had wholly failed to grasp the technical subject matter; and that the testimony of Owens-Corning's expert, Dr. Rochow, was false in important respects and had misled the court. In an order dated March 12, 1973, this court granted defendant's motion, applying collateral estoppel on the basis of the OCF case. Plaintiffs were thereafter permitted to amend the petition to allege infringement of certain claims of both the '378 and the '566 patents not considered in the OCF case and the suit proceeded with respect to the alleged infringement of claims 5, 10, 12, 13, 20, and 22 of the '378 patent and claims 2, 9 and 11 of the '566 patent.

On October 25, 1973, the District Court for the Northern District of Ohio once again considered the '378 patent. This time, Judge Thomas, in *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 380 F. Supp. 517 (N.D. Ohio 1973) (hereafter the MFG case), held that, although claims 5, 10, 12, and 13 of the '378 patent had not been litigated in the OCF case, nonetheless the issues presented by those claims were the same as those litigated in OCF, that plaintiff had a full and fair opportunity to litigate those issues in the OCF case, and that collateral estoppel prevented plaintiffs from further asserting those claims.

On April 11, 1974, defendant filed its second motion for partial summary judgment, requesting the court to rule that, by reason of the MFG decision, plaintiffs were collaterally estopped from asserting against defendant the validity of claims 5, 10, 12, and 13 of the '378 patent.

On June 27, 1974, the Sixth Circuit affirmed the decision of the District Court. *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 498 F. 2d 1115 (1974).

By an order dated November 21, 1974, the parties here were advised that a hearing would be held to determine, *inter alia*, "how the claims that have not been adjudicated on their merits in conformity with the requirements of *Graham* v. *John Deere Co.*, 383 U.S. 1 (1966), present issues any different in substance from the issues presented by the claims adjudicated in the Owens-Corning case." The hearing was held on January 23 and 24, 1975, at which time both parties put on testimony, introduced exhibits, and presented arguments.

In March 1975, in yet another suit in the Northern District of Ohio involving both the '378 and '566 patents, Judge Thomas summarily declared all claims of both the '378 and '566 patents to be invalid. *PPG Industries, Inc.* v. *Westwood Chemical, Inc.*, Civil Action No. C-71-49 (N.D. Ohio 1975) (unreported).[7] In what appears to be the only reference to the issue of validity in the memorandum and order, the court states.

> In *Westwood Chemical, Inc.* v. *Molded Fiber Glass Body Co.*, 380 F. Supp. 517 (N.D. Ohio 1973), 181 U.S.P.Q., *aff'd*, 498 F. 2d 1115 (6th Cir. 1974), this court determined that there was an identity of questions between the '378 patent claims adjudicated in *Westwood Chemical, Inc.* v. *Owens-Corning Fiberglas Corp.*, *supra*, and the '378 patent claims in the *Molded Fiber Glass Body* case, unadjudicated in the *Owens-Corning Fiberglas* case; and that "the affirmative defense of collateral estoppel [under *Blonder-Tongue*, *supra*] is justified and will be applied." For the same reasons the doctrine of collateral estoppel applies to the instant case; and a declaration of invalidity of all claims of '378 and '566 will be entered here.

On April 15, 1975, defendant filed its third motion for summary judgment, requesting a ruling, on the basis of

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[7] Plaintiffs indicate they have appealed that decision.

*Blonder-Tongue* and *PPG Industries*, *Inc.*, *supra* (hereafter the PPG case), that plaintiffs are collaterally estopped from asserting the validity of all of the remaining claims in issue, specifically claims 5, 10, 12, 13, 20, and 22 of the '378 patent and claims 2, 9, and 11 of the '566 patent.

## III.

With this background, the initial question presented is plaintiffs' contention that collateral estoppel does not apply at all to nonlitigated claims, that the MFG and PPG cases were erroneous as a matter of law in applying the estoppel in that manner, and that this court should neither apply estoppel based on either of those two decisions nor take the same approach as those cases. Plaintiffs' view is supported by some precedent, *Bourns*, *Inc.* v. *Allen-Bradley Co.*, 480 F. 2d 123 (7th Cir. 1973), *cert. denied*, 414 U.S. 1094, but is contrary to the view adopted by the Sixth Circuit in the MFG appeal. In large part, plaintiffs' argument stems from the principle, well established in the patent law, that each claim of a patent is to be considered as setting forth a complete and independent invention. 4 WALKER *Patents* § 263 (Deller's 2d ed. 1965). See, also, 35 U.S.C. §§ 253, 288. Indeed, those familiar with patent practice are aware that the patent attorney almost always presents to the Patent Office a set of claims, each differing in scope, one from the other, and usually running from the broadest permissible definition of the invention to a very specific definition of the invention. Out of such a set of claims, it would not be unusual for a broad claim to be found to be invalid but the more specific claim to be held valid. *See*, *e.g.*, *Southwest Industrial Products*, *Inc.* v. *Ezee Stone Cutter Manufacturing Co.*, 157 F. Supp. 208 (W.D. Ark. 1957), *aff'd*, 262 F. 2d 183 (8th Cir. 1958). Yet, it is also frequently the case that one claim in a patent may vary only slightly from another claim and that the issues of validity presented by the two claims are not significantly different. Indeed, in the OCF case, Westwood stipulated that the validity of a number of claims could be determined on the basis of certain representative claims. Hence, a rule that would limit the application of an estoppel only to specific claims seems to be much too mechanical and ignores the practicalities of patent practice. Moreover, it could well lend itself to abuse. For example, a patentee could readily circumvent the estoppel simply by litigating the patent one claim at a time, thus preserving to himself additional days in court against other defendants, even if, in his first suit, the particular claim litigated had been held invalid. Such a piecemeal approach to patent litigation is clearly contrary to the philosophy and goals sought to be achieved by *Blonder-Tongue*.

The correct approach, and the one adopted in this opinion, is believed to be that stated in *Carter-Wallace, Inc.* v. *United States*, 204 Ct. Cl. 341, 496 F. 2d 535 (1974), where it was held that, in determining the applicability of the estoppel, the first consideration is "whether the issue of invalidity common to each action is substantially identical." It is the issues litigated, not the specific claims around which the issues were framed, that is determinative. Only by focusing on the issues, and examining the substance of those issues, can the second court ascertain whether the patentee had the requisite full and fair chance to litigate the validity of his patent in the first suit. By the same token, only by using this approach can an attempt to relitigate the prior decision be revealed.

Having concluded that collateral estoppel may apply to nonlitigated claims,[8] the next issue is defendant's contention that the estoppel should be applied on the basis of the MFG and PPG cases. Except to express reservations about relying on one court's estoppel determination as the basis for a subsequent application of the estoppel,[9] that question need not be answered. The MFG case did not purport to deal with all of the claims here in issue so recourse must be made to the OCF case at least as to certain of the claims in any event.[10] There is little savings in time to be had by looking to the MFG case for some of the claims, evaluating the opportunity to litigate, etc., in that case and then, as to other claims, look to the OCF case and make the same kinds of determinations. Since the OCF case is the only one in which the issues of nonobviousness were explored and decided on their merits, and since the MFG case is premised on the OCF case, it is most expeditious, as well as appropriate, to evaluate the issues of estoppel on the basis of that decision alone.[11]

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[8] However, in all but the simplest case of a subsequent suit involving identical claims, any potential savings in time, both for the parties and the court, can be easily consumed, as in this case, by the motions, hearings, and briefs needed to evaluate and compare the issues raised by the claims. Naturally, if the estoppel is ultimately determined to be inapplicable to the unlitigated claims, the parties must proceed to trial and the total experience is a proceeding far lengthier than even the normally protracted patent case. This is not to say that in a case such as this, with multiple patents having both adjudicated and nonadjudicated claims, that an inquiry into the applicability of collateral estoppel, including a limited hearing for ascertaining the facts and avoiding duplicitous litigation, should not be held. There is a danger, however, where nonlitigated claims in a relatively complex technology are involved, that inquiry into the estoppel may just as easily perpetuate protracted litigation as eliminate it and it may well be as convenient to address the issues of validity on their merits.

## IV.

Looking then to the OCF case, the initial questions presented are whether in that case plaintiffs had a full and fair opportunity to litigate the issue of patent validity and whether the prior courts wholly failed to understand the technical subject matter. In effect, this court, by granting defendant's first motion for summary judgment, has already passed upon those questions. However, subsequent to that ruling, and at the hearing held in this case, defendant conceded that findings 94 through 100 in the OCF case were in error, and Judge Thomas, in the MFG case, reached the same conclusion. Those findings, which were in large part based upon the testimony of one of the principal expert witnesses for Owens-Corning, Dr. Eugene G. Rochow, professor of chemistry, Harvard University, related to two prior art Johannson patents on which both the District Court and the Court of Appeals placed substantial reliance in invalidating the claims at issue.[12] Judge Thomas found Dr. Rochow's testimony to be "clearly mistaken or at least misleading," a conclusion well supported by the record.

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[9] Defendant has cited no case in which an estoppel determination by one court has been relied upon as the basis for imposing an estoppel in another court. It would appear from the *Technograph* cases that each court in which the estoppel is asserted should satisfy itself that the estoppel is properly applied. *See, Technograph Printed Circuits, Ltd.* v. *Martin-Marietta Corp.*, 340 F. Supp. 423 (D. Md. 1972), *aff'd*, 474 F. 2d 798 (4th Cir. 1973), *cert. denied*, 414 U.S. 880; *Technograph Printed Circuits, Ltd.* v. *Methode Electronics, Inc.*, 174 USPQ 297 (N.D. Ill. 1972), *aff'd*, 484 F. 2d 905 (7th Cir. 1973); *Technograph Printed Circuits, Ltd.* v. *United States*, 202 Ct. Cl. 867, 484 F. 2d 1383 (1973). Such an approach is in keeping with the Supreme Court's observation in *Blonder-Tongue* that application of the estoppel is not an automatic matter and that the ultimate test of whether the estoppel is to be applied necessarily rests "on the trial courts' sense of justice and equity." 402 U.S. at 334.

[10] While the PPG decision purported to invalidate all of the claims, it expressly relied on the MFG case as its only authority for doing so. The '566 patent was not even considered in the MFG case so the basis for holding it invalid on the authority of that case is not at all clear. The same problem exists with respect to the claims that were not considered in MFG.

[11] The principle of comity, of course, dictates that the MFG decision is to be accorded the deference paid to the judgments of other coordinate tribunals, *Mast, Foos & Co.* v. *Stover Mfg. Co.*, 177 U.S. 485, 488–89 (1900), and is entitled to substantial weight on all common questions. *See, e.g., King-Seeley Thermos Co.* v. *Millersville Mfg Co.*, 296 F. Supp. 247 (M.D. Tenn. 1968), *aff'd*, 412 F. 2d 318 (6th Cir. 1969).

Another development, which arose as a result of the hearing held in this case, relates to the testimony of defendant's expert, Dr. Maurice Jellinek, who testified with respect to the Steinman Patent No. 2,513,268, pertaining to the allyl silicates. It was conceded by Dr. Jellinek that the allyl silicates, when exposed to a moist or humid environment, hydrolyze at the silicon-oxygen bond of the allyl radical to form allyl alcohol and silicic acid. Thus, the bond is *destroyed* and the resin and substrate *separate*. In light of that testimony, the conclusion in Judge Connell's finding 104 that the allyl silicates "are structurally similar and function in the same manner as the allyl silanes and vinyl silanes" is misleading, if not incorrect. While the silicates initially couple by means of the same mechanism as the silanes, and while both will function in accordance with the "double fishhook" theory of Steinman, the bond formed by the silicates is destroyed when exposed to normal environmental conditions. In other words, the difference between Steinman's silicates and the silanes claimed here is that the former is of no practical value while the latter is highly useful. The Sixth Circuit relied on finding 104 in affirming the trial court's holding of obviousness, citing the Steinman patent as the "most revealing" of the prior art teachings not considered by the Patent Office. Yet, nowhere in either Judge Connell's opinion or that of the Sixth Circuit is there any recognition of the fundamental difference in result achieved by these two similar materials.[13]

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[12] When properly construed, the two Johannson patents are clearly of little import to the issues of validity in the OCF case and further reduces the number of pertinent prior art patents from the original nine relied upon by Judge Connell in his opinion down to five.

It is to be emphasized that the errors in findings 94–100 and the questionable validity of finding 104 have been established, not by reason of "unbridled excursions into the record of the earlier trial," *Kaiser Industries Corp.* v. *Jones & Laughlin Steel Corp.*, 515 F. 2d 964, 987, 185 USPQ 343, 361 (3d Cir. 1975), but rather, they appear on the basis of defendant's concessions and presentation in this case. Since these matters relate to technical facts upon which the OCF court clearly relied in its holding of obviousness, it draws into question whether the order granting defendant's first motion for summary judgment should be reconsidered.

After considering the matter at some length, and having in mind the guidelines and objectives set out in *Blonder-Tongue*, it has been concluded that, these errors notwithstanding, they do not rise to the level of demonstrating that either Judge Connell or the Sixth Circuit wholly failed to grasp the technical subject matter and issues in suit.[14] Understanding the technical subject matter necessarily involves at least two aspects, the first being the technology of the patent in suit and the second being the technology of the prior art. While a correct understanding of both aspects is necessary to a proper resolution of the obviousness issue, the demonstrated failure of a court properly to assess the technical implications of some *part* of the prior art simply will not support the conclusion that the court *wholly* failed to grasp the technical subject matter in issue. That is the situation here. There is no doubt that the OCF court understood the technical subject matter of the patents in suit; nor is there any doubt it had a correct understanding of such prior art patents as those to Kropa,[15] Hyde, and Biefeld. To the extent it may have misunderstood the scope of the Steinman teachings and, to the extent that it was misled regarding the teaching of the Johannson patents, those were matters properly for consideration on appeal. This court cannot, and will not, presume to act as an appellate forum to correct errors which could have been raised on appeal. Even if it is shown that those errors were in fact asserted on appeal and that the appellate court failed to recognize the validity of the patentee's contentions, that will not be enough to avoid application of the estoppel unless it is also shown that the reviewing court *wholly* failed to grasp the technical subject matter and issues. Plaintiffs have not been able to make that showing here. In the absence of establishing that fundamental feature of a successful defense to an estoppel assertion, plaintiffs can only complain that the prior decisions were erroneous. As it has been observed by other courts, the correctness of the earlier decision is not an issue and is not a prerequisite to the application of the estoppel. *Kaiser Industries, supra; University of Illinois Foundation* v. *Blonder-Tongue Laboratories, Inc.*, 334 F. Supp. 47, 50 (N.D. Ill. 1971), *aff'd*, 465 F. 2d 380 (7th Cir. 1972), *cert. denied*, 409 U.S. 1061.

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[13] Of the four remaining prior art patents relied upon in the OCF case, one was a file wrapper reference and the other three, although not specifically cited by the Patent Office, are merely duplicative of some that were.

[14] Since those errors do not bear on the issue of whether plaintiffs had a full and fair opportunity, evidentially and procedurally, to litigate in the OCF case, there is no need for the court to reconsider its earlier determination, implicit in its order of March 12, 1973, that plaintiffs did have such an opportunity.

## V.

There remains the question, then, of whether the issues of validity presented by unadjudicated claims 5, 10, 12, 13, 20, and 22 of the '378 patent and claims 2, 9, and 11 of the '566 patent are substantially identical to the issues of validity decided by the OCF court. In approaching that question, it should be noted that, while it is convenient to refer to the

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[15] Plaintiffs do urge that error was made in the OCF courts with respect to Kropa Patent No. 2,465,731. It is argued that the courts failed to ascertain the difference between the reaction occurring in the claimed invention, wherein the silane is applied to the substrate and the resin thereafter applied to the treated substrate, and that occurring in Kropa where an allylchlorosilane, *e.g.*, allyl trichlorosilane, is copolymerized with unsaturated resins such as those disclosed in the '378 and '566 patents. This resultant mass is then applied as a coating or varnish to a fibrous glass substrate. The result is a coating which adheres tenaciously to glass. Having reviewed the opinions of the OCF trial and appeal courts, as well as the evidence adduced at the separate hearing in this case and the arguments of counsel, it is concluded that there is no showing sufficient to establish that the OCF courts misinterpreted the teachings of this reference.

"issue of patent validity," that can be misleading. Where obviousness is the basis for the prior invalidity holding, an inquiry into the identity of the validity issue is more properly phrased in terms of the factual inquiries mandated by *Graham* v. *John Deere Co.*, 383 U.S. 1, 17 (1966), as a prerequisite to such a validity determination. Thus, the inquiry should be whether the nonlitigated claims present new issues as to the art pertinent to the nonlitigated claims; as to the scope and content of that art; as to the differences between the prior art and the nonlitigated claims; and as to the level of ordinary skill in that art. If none of these inquiries raises any new triable issues, then the obviousness determination in the prior proceeding should be equally applicable to the nonlitigated claims.

Perhaps the most convenient way to approach a determination of these issues is, as Judge Thomas did in the MFG case, to compare the litigated and nonlitigated claims. If they are of identical scope, it readily follows that no new issues bearing on the obviousness determination are presented. On the other hand, such a comparison may reveal some differences of a substantive nature. In that event, it will be necessary to go a step further and determine whether those differences are of a kind that would have been itemized in a *Graham* analysis as a difference between the claim and the prior art, or whether it was known in the prior art and is only a part of the claimed combination as a whole that provides the context in which the obviousness determination is made. If it is only of the latter character, *i.e.*, it is known in the prior art and does not alter the issue as to the differences between the claimed subject matter and the prior art, it is still necessary to assess the importance of the difference to the combination as a whole since it is from that standpoint that the obviousness determination must be made. *Jacobson Brothers, Inc.* v. *United States*, 206 Ct. Cl. 518, 512 F. 2d 1065 (1975); *B. G. Corp.* v. *Walter Kidde & Co.*, 79 F. 2d 20, 22 (2d Cir. 1935).

Here, neither party urges any new or different issue as to the pertinent prior art, the scope and content of that art, or the level of skill in that art. The dispute here is whether the differences between the prior art and the nonlitigated claims are distinguishable from the differences between the prior art and the previously litigated claims. Plaintiffs contend that the differences presented by the nonlitigated claims are distinguishable substantially from those differences previously held to be obvious, while defendant urges the contrary. In particular, defendant contends that the substantial identity of the validity issues is apparent from matching up the claims in the following manner:

| *Unadjudicated Claim* | *Adjudicated Claim* |
|---|---|
| 5 | 15 |
| 10 | 11 |
| 12 | 3 |
| 13 | 7 |
| 20 | 19 |
| 22 | 21 |
| 2 | 8 |
| 9 | 8 |
| 11 | 8 |

Turning first to a comparison of claims 5 and 15, the parties are agreed that the sole distinction between these two claims is that claim 5 describes the olefinic polymerizable liquid as having "groups which react with olefine groups" while the olefinic liquid in claim 15 is not so limited. Plaintiffs assert that claim 15 literally reads upon the use of olefinic polymerizable liquids that have either nonreactive or stearically hindered olefine groups and, hence, can polymerize only by condensation and are therefore inoperative to produce a chemical bond. Claim 5, plaintiffs argue, thus is narrower than claim 15 and includes only olefinic polymerizable liquids that are operative to produce a chemical bond.

Such a strained and unreasonable interpretation of the adjudicated claim cannot be accepted. Although it is true that there are olefinically unsaturated monomers that polymerize solely by condensation polymerization and cannot, due to the stearic hindrance, polymerize by the addition mechanism, it is not reasonable to assume that Judge Connell was reading the claim in that manner when he held it invalid. The only normal and reasonable meaning of the phrase "olefinic polymerizable liquid," as it is used in the context of the claim, is that the liquid has groups which react with olefine groups and is a liquid monomer which polymerizes by *addition* polymerization. There is nothing to indicate that the claim draftsman would have described the liquid by *non*reactive terms and plaintiffs' expert witness (and patent counsel) admitted as much at the hearing.

Any doubt about the intent of the patentee in drafting the claims is resolved by the specification of the '378 patent where it is stated, in column 4, lines 29–40, that:

> In accordance with the present invention, the fabric which has been treated as above is contacted or immersed in a composition comprising a polymerizable olefinic compound and preferably a polymerizable mono-olefinic compound of less than 6 aliphatic carbon atoms and capable of polymerizing by free radical initiators such as a peroxide and hydroperoxide catalyst, and the polymerizable olefinic compound is subjected to catalyst and caused to polymerize and cause to set to the solid state while in contact with the treated fabric *whereby interaction of double bonds on fabric and monomer occur to build the fabric chemically into the solid molecule.* (Emphasis added.)

From this it is apparent that the disclosed polymerization technique is addition, *i.e.*, reaction of the olefinic or double bonds, and there is no dispute that addition polymerization requires that the olefinic polymerizable liquid have olefinic groups which react with the olefinic groups of the coupling agent. The remainder of the specification, without exception, is drawn to addition polymerization mechanisms and never mentions or infers either condensation polymerization or an olefinic polymerizable liquid not capable of addition polymerization.[16]

Hence, the expression "olefinic polymerizable liquid" appearing in claim 15 is properly understood to mean an olefinic polymerizable liquid capable of reacting with vinyl siloxane, *i.e.*, "having groups which react with olefine groups." As so interpreted, claims 5 and 15 present identical issues and collateral estopell should extend to both claims.

With respect to adjudicated claim 11 and unadjudicated claim 10, there are essentially three differences between them. The first difference is as to the substrate specified, claim 11 reciting "fibers and inorganic pulverulent solids" while claims 10 recites "fibers and inorganic pulverulent pigments." This difference is clearly without substance as shown, for example, from column 8, lines 17–20, of the specification wherein it is stated that "[t]he term 'pigments' is used herein and in the appended claims in the generic sense * * * to include powders, fillers, and pulverulent inorganic solids generally * * *."

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[16] It is, of course, appropriate to look to the specification, to understand the meaning of a claim. *Autogiro Co. of America* v. *United States,* 181 Ct. Cl. 55, 61, 384 F. 2d 391, 396 (1967).

The second difference on which plaintiffs rely is the recitation in claim 10 of a "free radical catalyzed monomeric polymerizable liquid olefine." Claim 11 does not specify the monomer as being "free radical catalyzed." However, as discussed with respect to claim 15, it is clear that the expression "liquid polymerizable olefinic monomer" is intended to mean a monomer capable of reacting by addition polymerization with the olefinic bond of the coupling agent. Thus, claims 10 and 11 are both directed to addition polymerization, but claim 10 is limited to free radical addition polymerization while claim 11 is open to additional techniques, such as addition by the Friedal-Crafts catalyst method.

It is a notoriously old technique to use a catalyst as a reaction accelerator. The Kropa patent, for example, suggests a free radical catalyst in the same overall combination of materials as claims 10 and 11. Indeed, the lack of significance in the particular catalyst used is recognized in the '378 patent, at column 7, lines 68–75.

The third difference is that claim 10 specifies a monomer having two sets of double bonds while the number of double bonds of the monomer is not specified in claim 11. It is clear from the specification (col. 8, lines 1–4) that the number of double bonds is not significant, the patentee's invention residing in the chemical bond between the monomer and the coupling agent, not in the number of double bonds possessed by that monomer. Further, the use of a monomer having two sets of double bonds is expressly disclosed in Kropa.

In sum, plaintiffs have pointed out some differences between claims 10 and 11 but those differences do not distinguish the claim from the prior art. Since claims 10 and 11 present the same differences from the prior art, there is no substantive reason for relitigating the issue of obviousness of those differences, albeit in the context of the slightly different combination of claim 10, and the estoppel should apply to claim 10.

Adjudicated claims 3 and 7 and unadjudicated claims 12 and 13 of the '378 patent may be considered together since the only apparent difference resides in the substrate. Claims 3 and 7 describe the substrate as a member selected from "fibers and inorganic pulverulent solids" while the unadjudicated claims describe it as "an inorganic pigment." As discussed with respect to claims 10 and 11, the term "pigments" as defined by the patentee is intended to be generic to "inorganic pulverulent solids." On the basis of the record before the court, there can be no doubt that the issue of obviousness of the patentee's chemical-bond concept is the same whether the substrate is described as fibrous, inorganic pulverulent solids, or inorganic pigments. Accordingly, no substantively different issue is presented by claims 12 and 13 which would justify a further trial.

Turning to claim 20, it was established at the hearing that the sole distinction between that claim and claim 19 is that claim 20 specifies chlorvinyl groups bonded to the surface of the fibers through a silicon-oxygen linkage while adjudicated claim 19 calls for vinyl groups. The term "vinyl" is used in claim 19 broadly to refer to both substituted and unsubstituted monovalent olefinically unsaturated hydrocarbon radicals having two carbon atoms as, for example, a vinyl silane. Thus, claim 20, in specifying chlorvinyl groups, such as a chlorvinyl silane, as the coupling agent might be viewed as being of narrower scope than claim 19.

Plaintiffs assert:

> No prior art has ever been cited disclosing "chlorvinyl groups" for application to any substrate.

The record is to the contrary. For example, Hyde Patent No. 2,390,370 discloses the use of "hydrolyzable organosilicanes, their hydrolysis products and their polymerized hydrolysis products" in coating glass fibrous substrates. This generic grouping is disclosed as including derivatives of $SiH_4$ which contain readily hydrolyzable organic radicals joined to the silicon atom through carbon atoms. Suitably disclosed organic radicals include the alkenyl radical (vinyl, allyl, etc.)

which may contain halogen substituents (chlorine, bromine, etc.). Hence, a chlorvinyl silane would be included in the Hyde disclosure.

Moreover, plaintiffs' expert witness (and patent counsel) admitted at the hearing that there is essentially no difference in function or result achieved with the chlorvinyl as compared to the vinyl. The '378 patent specification confirms this admission by listing the chlorvinyl species among other species which fall within the generic vinyl grouping as suitable for use in the invention. There is no indication in this specification that the chlorvinyl performs any better or any worse than other suitable species. Defendant's expert witness also testified that chlorvinyl silane coupling agents perform in an essentially equivalent manner to accomplish substantially the same results as other types of vinyl silane coupling agents.

In view of the foregoing, it is concluded that the recitation in claim 20 of a chlorvinyl silane coupling agent does not alter the issues decided adversely to plaintiffs in the adjudication of claim 19 in the OCF case.

With respect to unadjudicated claim 22, the sole difference between it and adjudicated claim 21 is in the recitation of a "vinyl silicon trihalide" as the coupling agent in claim 22. Claim 21 describes the coupling agent as a "vinyl silicon halide" and is sufficiently broad to include the mono-, di-, and trihalides.

It was established at the hearing by the testimony of defendant's own expert witness that there are in fact actual significant differences in the preparation of composite articles using vinyl silicon halide coupling agents generally, as opposed to those using vinyl silicon trihalide coupling agents. It appears that, as the halides are replaced by organic groups, the performance of the material decreases. One form of a trihalide, the trichlorosilane, has been found to be the cheapest and easiest coupling agent to prepare and use, and it provides a superior bond between the substrate and the resin.

When vinyl trichlorosilane is applied to a substrate in an aqueous medium, which is conventional, hydrochloric acid readily forms and the three silicon valences formerly bonded to the chlorine readily pick up hydroxy groups, which in turn chemically react with the substrate to form silicon-oxygen linkages with the substrate. On the other hand, when using a monohalide or dihalide as the coupling agent, the presence of organic radicals on the remaining silicon valences, so-called "blocking groups," inhibits chemical bonding of the three potential silicon linkages to the substrate and thus provides a product of decreased strength.

Plaintiffs urge that the improved performance of the trihalide coupling agent raises separate and distinct questions with regard to claim 22 and that the first element of *Blonder-Tongue*, identity of issues, is thus absent as to this claim.

Plaintiffs' arguments cannot be accepted for a number of reasons. In the first place, the Kropa patent expressly teaches the use of silicon trihalides, and chlorosilane specifically, as a coupling agent for achieving a tenacious adherence to a glass substrate. Thus, in terms of a *Graham* analysis of claim 22, the recitation of a silicon trihalide as a coupling agent is not something that would have been identified as a difference from the prior art. Further, the arguments and evidence as to the commercial success of the trichlorosilane are not particularly pertinent to the claimed process. Claim 22 calls for contacting the fibers with the trihalide while, in commercial practice, the vinyl trichlorosilane is converted to vinyl trialkoxy silane to prevent deterioration of the glass by the HCl and then applied to the fibers Thus, the commercial practice on which the claim of success is predicated is something different from the claimed process and, hence, of little significance *Jacobson Brothers, Inc.* v. *United States*, *supra.* Finally, there is nothing in the specification indicating that the trichloro species possesses any advantages over other trihalides or, indeed, over vinyl silicon halides generally. Advantages, not set forth in the specification, are of little weight in assessing the validity of an invention. *Graham*, *supra*, at 25; *Pacific International Plastics* v. *Sterling Plastics Corp.*, 305 F. Supp. 1341 (C.D. Calif. 1969); *In re Stewart*, 222 F. 2d 747 (CCPA 1955).

In sum, the differences between the prior art and claims 21 and 22 are the same so no new issue is presented by claim 22 in that respect. While the specific recitation of a trihalide does define a slightly different overall combination of elements to be considered in the obviousness determination, the secondary considerations urged by plaintiffs as bearing on that combination do not provide an adequate basis for relitigating that determination.

Turning now to the '566 patent and unadjudicated claims 2, 9, and 11, the first difference between these claims and previously adjudicated claim 8 is as to the particular substrate recited. There is nothing in either the patent or plaintiffs' presentation on which to conclude that the particular substrate raises any new or different issues. Accordingly, as noted previously, these "differences" are insufficient to defeat application of the estoppel.

The second difference in the claims resides in the recited coupling agent. Adjudicated claim 8 describes it as:

> * * * an olefinically unsaturated organosiloxane group in which carbon-to-carbon double bonds are spaced by at least one carbon atom from the silicon atom carrying the organic group of said organosiloxane group, said olefinically unsaturated group being an alkylenyl group having not over twenty carbon atoms.

As described, this would include the alkenyl groups ranging from allyl up to and inclusive of those having 20 carbon atoms. Claims 2 and 11 recite an allyl siloxane group and claim 9 recites an allyl or substituted allyl siloxane group. Thus, claim 8 is generic while claims 2, 9, and 11 are specific to allyl.

The use of alkenyl silanes, including the allyl species, for treating substrates was well known in the prior art. See, for example, Biefeld Patent No. 2,392,805 and Hyde Patent No. 2,390,370. Indeed, it appears from the OCF opinion that it was the disclosure of the allyl species in these prior art patents that was the basis on which generic claim 8 was invalidated. The genus having been held invalid on the basis of the teaching of the species in the prior art, it follows that a claim to the species can raise no new issues.

The final distinction is that claims 8 and 2 are method claims while claims 9 and 11 are product claims. While processes and products are separate categories of invention, 35 U.S.C. § 101, nevertheless, it is not inconsistent to state that a process and product may present identical issues concerning, *e.g.*, their obviousness. *Cf.*, *In re Conover*, 304 F. 2d 680 (CCPA 1962). Thus, this distinction, without more, is of no merit and does not defeat application of the estoppel.

## VI.

The foregoing analysis has been considerably more thorough than is normally to be expected when issues of collateral estoppel are raised. In part, this is the necessary result of the conclusion that collateral estoppel may extend to nonlitigated claims. Moreover, in light of the errors in the OCF case that have now been revealed,[17] it was felt that justice and equity required nothing less. The presence of those errors has made the question of whether to extend application of the collateral estoppel to unadjudicated claims a most difficult one. In a sense, to do so is to perpetuate and enlarge the error, something that neither justice nor equity will support. On the other hand, a complete review of the prior proceedings and the evidence now before the court reveals two fundamental facts. The patentee's invention, his contribution to the art, in both the '378 and '566 patents, was, in fact, squarely placed in issue and litigated in the OCF case, both at trial and on appeal. Further, such minor differences as exist between the litigated claims and those here in issue are so insubstantial that the issues of validity under *Graham* v. *John Deere*, must be considered to be the same. In those circumstances, it is apparent that any further proceedings in this court would simply be a relitigation of the obviousness determination in the OCF case. The rule in *Blonder-Tongue* was expressly intended to avoid just such a result.

Finally, it is worthy of note that plaintiffs' arguments regarding the opportunity to litigate in the OCF case and whether Judge Connell understood the technical issues were presented to the Sixth Circuit in the OCF appeal, to Judge Thomas in the MFG case, again to the Sixth Circuit in the MFG appeal, to this court in opposition to the first motion for summary judgment, and now, once again, in opposition to the present motions. It is also worth mentioning that the

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[17] The rather unusual posture assumed by the Department of Justice in vigorously opposing any suggestion of error in the OCF case when plaintiffs first asserted it, and then *conceding* the error in these proceedings, has also contributed to the decision to review the matter thoroughly.

OCF case was in a forum and against a defendant selected by plaintiffs. It is believed that, in light of these facts, it is not unjust, inequitable, or in any way unfair to conclude that plaintiffs have had their day in court and that litigation on these patents should now come to an end.

Based on the foregoing, it is concluded that the estoppel arising from the OCF case should extend to all of the claims here in issue, thereby foreclosing any recovery by plaintiffs in this case.

### CONCLUSION OF LAW

Upon the foregoing opinion, which is made a part of the judgment herein, the court concludes as a matter of law that plaintiffs are not entitled to recover and the petition is dismissed.

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524 F. 2d 1178

## DEL MAR ENGINEERING LABORATORIES v. THE UNITED STATES

[No. 27-71. Decided October 22, 1975]

### ON THE PROOFS

**Patents; patentability; obviousness; prior publication; prior knowledge; classified information; suppression or concealment.**—Plaintiff seeks reasonable and entire compensation for the alleged unauthorized use and manufacture by or for the United States of an invention described and claimed in U.S. Patent No. 2,869,120 relating to an aerodynamically stable target structure towed by an aircraft and used to simulate a self-propelled aircraft, for realistic practice by the military in detecting, tracking and intercepting aircraft by use of automatic and semi-automatic fire and missile control systems. Defendant contends that the claims are invalid on the basis of 35 U.S.C. §§ 102 (a) and (g) and § 103. It is *held* (1) as to claims 1-4, it would have been obvious in 1956 (when the subject matter of the claims in suit was conceived) to one of ordinary skill to employ radio-actuated flares on a target such as those disclosed in the cited Hopper patents; (2) as to the classified work in 1955-56 at the Naval Ordnance Test Station (the Dart work), defendant has not sustained its burden in establishing a prior public use under § 102(a), and accordingly this work is not a bar under said section; (3) that the evidence regarding the Dart is sufficient to invalidate claims 1, 3 and 4 under 35 U.S.C. § 102(g), and in the absence of any showing that defendant, by its security classification system, attempted to exclude the public from the benefit of the work, there was no suppression or concealment for purposes of § 102(g); and (4) that, considering the level of skill in the art and in view of the well-known use in the ordnance and armament field of safety switches to prevent accidental detonation or ignition, claims 5–7 are invalid for obviousness. Plaintiff is not entitled to recover and the petition is dismissed.

**Patents; patentability; obviousness; generally.**

[1] Determination of whether the subject matter of a patent is obvious within the meaning of 35 U.S.C. § 103, though ultimately a question of law, necessarily involves the factual determination of (1) the scope and content of the prior art, (2) differences between the prior art and the claims at issue, and (3) level of ordinary skill in the pertinent art.

Patents ⚿ 18

**Patents; patentability; new use or function.**

[2] A distinction based on plaintiff's principal use of flares on its targets for one purpose and the prior art's use of flares for a different purpose cannot preserve the validity of a claim not limited in terms of the use to which the flares are put and which reads on a target having flares employed for either use.

Patents ⚿ 42

**Patents; patentability; prior knowledge or use.**

[3] Where the evidence establishes that a prior device was successfully reduced to practice before the invention of the patent in suit, the former is available as prior art and its subsequent abandonment is irrelevant.

Patents ⚿ 30(1)

**Patents; patentability; prior publication/prior knowledge or use; classified documents.**

[4] Classified documents whose security classification was not removed until after the invention of the patent in suit are not prior publications or evidence of prior knowledge, as they are not "public" within the meaning of 35 U.S.C. § 102(a). These principles are not altered merely because the patentee had a security clearance, absent evidence of actual knowledge by the patentee of the prior secret work. The mere fact that an individual has a security clearance does not justify the conclusion that he had, or could have had, access to specific classified documents.

Patents ⚿ 55

**Patents; patentability; prior knowledge or use; classified documents; evidence of level of skill in art.**

[5] Although classified documents, and the work on which they are based, whose security classification has not been removed are not prior publications or evidence of prior knowledge within the meaning of 35 U.S.C. § 102(a), they do supply probative evidence

on the issue of what the general level of skill in the art was at the time the invention of the patent in suit was made, and the work reflected in the documents is some evidence of what those confronted with a similar problem at the time of the subject invention would have proposed as a solution to that problem.

Patents 🔑 60

**Patents; patentability; obviousness; solution of problem by others.**

[6] That the patentee and another party, both working independently, arrived at the same combination of elements to achieve the desired solution is confirmatory that the combination was obvious.

Patents 🔑 18

**Patents; patentability; prior knowledge or use.**

[7] Under 35 U.S.C. § 102(g), a prior invention, i.e. one that has been reduced to practice and not abandoned, suppressed, or concealed, is sufficient to invalidate a claim or claims even though it was not "public" at the time the patented invention was made.

Patents 🔑 55

**Patents; patentability; conditions for patentability; suppression or concealment.**

[8] Each case involving the issue of suppression or concealment must be considered on its own particular set of facts. No one set of circumstances, no one controlling fact automatically establishes a suppression or concealment. It is the effect of the particular facts on the primary purpose behind 35 U.S.C. § 102(g), viz. the encouragement of public disclosure of new inventions, that is determinative.

Patents 🔑 55

**Patents; patentability; conditions for patentability; suppression or concealment; classified documents.**

[9] The fact of security classification should not be regarded per se a suppression and concealment for purposes of 35 U.S.C. § 102 (g); rather, it should be deemed as but one fact in the totality of particular facts applicable to the specific situation under consideration.

Patents 🔑 55

**Patents; infringement; invalid patent.**

[10] An invalid patent cannot be infringed.

Patents 🔑 226

*J. B. McGuire*, attorney of record, for plaintiff.

*Donald E. Townsend*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

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Before Cowen, *Chief Judge*, Davis and Nichols, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed June 13, 1975, moving that the court adopt as the basis for its judgment in this case the recommended decision of Trial Judge Hal D. Cooper, filed April 28, 1975, pursuant to Rule 134(h) since plaintiff has failed to file a timely notice of intention to except thereto. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. Therefore, it is concluded that plaintiff is not entitled to recover and the petition is dismissed.

## OPINION OF TRIAL JUDGE

COOPER, *Trial Judge:* Plaintiff, under 28 U.S.C. § 1498, seeks reasonable and entire compensation for the alleged unauthorized use and manufacture by or for the United States of an invention described in claims 1 to 7, inclusive, of United States Letters Patent No. 2,869,120, entitled "Tow Target Having Combustion Signal Means."

The invention delineated in the patent was developed in response to the Air Force's need for a suitable target to test the effectiveness of its then-new heat-seeking missiles. Specifically, the invention relates to an aerodynamically stable structure which is towed behind a tractor aircraft and used to simulate a self-propelled aerial object such as a jet aircraft. When used in this manner, it provides for inexpensive, yet realistic practice for the military in the detection, tracking, and interception of such aircraft by the use of automatic and semiautomatic fire and missile control systems. The target is particularly designed to be carried aloft by a tow plane, released and towed at a considerable distance behind the plane, and recovered by the tow plane before landing, if it has not been destroyed by the missiles fired at it.

The preferred embodiment of the patented device comprises a streamlined target structure having a body of low-drag aerodynamic configuration formed from a hollow, thin-walled, radar-permeable, rigid material, a corner radar reflector incorporated within the body of the tow target, and a plurality of rearwardly directed flares mounted to the trailing end of the tow target body. The flares are used to simulate representative infrared (IR) emissions characteristic of jet aircraft. Carried within the body are a radio receiver and battery to develop an output signal in response to a signal received from a remote signal generating source to actuate ignitors electrically connected to the battery for igniting the flares. A plurality of fins of a nonmetallic material are carried by the trailing portion of the body member for stabilizing the target in towed flight, and elements are embedded within these fins to form an antenna for the radio receiver. Canted tabs on the fins cause the target to rotate as it is towed. The patent teaches that the flares may, by means of a sequencing switch, be ignited in succession or at selected stages, depending on their purpose. Usually, the invention provides for timing the combustion period by remote control to occur at a critical or controlling stage in a countermeasure procedure.

To prevent accidental or inadvertent ignition of the flares, a built-in safety system is provided which includes a normally closed switch that is maintained in an open position by a safety pin when the tow target is on the ground. The normally closed switch opens automatically whenever the tow target is stored or snubbed on the towing aircraft and closes automatically to complete the ignitor circuit when released from the plane.

As in most patent cases, the basic thrust of the defense is the contention that the claims in issue are invalid. In this case, the invalidity defense is based on 35 U.S.C. § 102(a) and (g) and § 103 (1964). For the reasons stated hereinafter, the § 102(g) defense is a sound one as to claims 1, 3, and 4 and defendant has carried its burden with respect to the § 103 defense as to all of claims 1–7.

Addressing first the § 103 defense, a determination of whether the subject matter of a patent is obvious, though ultimately a question of law, necessarily involves the following three-tiered factual determination:

> Under § 103, the scope and content of the prior art are to be determined; differences between the prior art and the claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved. Against this background, the obviousness or nonobviousness of the

> subject matter is determined. * * * [*Graham* v. *John Deere Co.*, 383 U.S. 1, 17 (1966).]

The subject matter of the claims in suit was conceived in April 1956. Prior to that time, it was well known that aircraft could be simulated for purposes of rocketry or gunnery practice by use of aerodynamically stable targets towed behind manned tractor aircraft. The Hopper patents, 3,137,852 and 3,128,463, assigned to plaintiff, disclose a streamlined, nose-towed, tow target with radar reflectors carried on board to provide a target for radar-directed weaponry. The state of the prior art existing at this time is further illustrated by plaintiff's own RADop series of tow targets which were offered for sale to the Air Force in July 1955 and which are of the same basic design as that shown in the Hopper patents. These targets were lightweight, streamlined, radar-permeable, spin-stabilized hollow members of aerodynamically stable configuration which were carried aloft by tow aircraft and streamed on a towline behind the tow plane a suitable distance for gunnery, rocketry, or missile practice. They could be recovered in some cases by being reeled into the tow plane and in others by being parachuted to the ground.

Although the RADop target did not contain any type of electrical control or power system thereon, it was well known prior to 1956 that tow targets could be equipped with radio-link receivers to actuate various devices carried by the target. Plaintiff's DELta tow targets, for example, though of much more complex configuration than the RADop, carried a variety of equipment such as batteries, radios, radar and visual augmentation devices, smoke markers, parachutes, radar corner devices, and the like. The use of a radio link to a target had also been used, prior to 1956, with drones, which were pilotless radio-controlled aircraft. For purposes of tracking and photographing the drone during missile firings, drone targets had been equipped with radio-actuated flares as early as 1954. Of course, the fact that flares are a source of IR emission was notoriously well known.

With respect to the use of safety switches, it was known long prior to 1956 to use various types and kinds of safety switches to disarm ordnance to prevent its accidental detonation during handling and transportation. Typically, these switches were effective to arm the ordnance only after it had been released from the airplane.

Based on the foregoing prior art, the differences between that prior art and the claims in suit (the second factual determination required by *Graham*) lie in two areas: as to claims 1 through 4,[1] the differences reside primarily in the selection and use of radio-actuated flares on a specific kind of towed target; as to claims 5 through 7,[2] an additional aspect is the use of a safety means to prevent premature ignition of the flares on the towed target.

Based on these differences, and with particular reference to claim 1, the question is whether it would have been obvious in 1956 to one of ordinary skill to employ radio-actuated flares on a target such as those disclosed in the Hopper patents. It is concluded that this question must be answered affirmatively. It is to be noted that the combination defined by claim 1 is simply plaintiff's own prior RADop target with radio-actuated flares added to it. As pointed out previously, the use of radio-actuated flares was known to those in the field of aerial targets, having been used as visual aids for tracking and photographing of targets such as drones. Merely adding this known feature to the RADop target does not appear to be at all unobvious. In this regard, it is, of course, the fact that the flares on plaintiff's targets are used principally as an

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[1] Claim 1 is representative of claims 1–4 and is as follows:

"1. An aerial tow target comprising a hollow thin-walled rigid body member having a low drag aerodynamic configuration, the walls of said body member being formed of a non-metallic material permeable by radar waves; means defining a plurality of normally intersecting planes interiorly of said body member and having a metallic surface for reflecting exteriorly propagated radar waves; a rearwardly directed flare magazine mounted to the trailing end of said body member; a plurality of rearwardly directed flares mounted in said magazine; a radio receiver carried within said body member, said radio receiver developing an output signal in response to a received signal from a remote source; and means for igniting said flares in sequence, including means responsive to said output signal of the radio receiver, whereby said flares are ignited in response to the received signal from the remote source."

[2] Claim 5 is representative and is as follows:

"5. An aerial tow target for practice in the detection of self-propelled aerial objects, comprising: a streamlined body for connection to a tow cable; at least one charge of rapidly combustible material carried by said body to create a highly visible flame; remotely controlled ignition means on said body to ignite said charge; means for supporting said body on an aircraft for transportation to a practice area; and safety means to make said ignition means inoperative in response to engagement of the body by said supporting means."

IR source while the prior art use of flares mentioned previously was for a different purpose; however, claim 1 is not limited in terms of the use to which the flares are put and is as readily read on a target with signal flares as on one with flares used as an IR source. Indeed, the patent recognizes visual identification as one of the purposes for which the flares may be used. (Col. 1, lines 22–37.) Hence, a distinction based on the purpose or use of the flares cannot be relied upon to preserve the validity of the claim.

Two other factors support this conclusion of obviousness. The first is the work in 1955–56 at the Naval Ordnance Test Station where a target, designated the Dart, was developed. That target utilized flares as an IR source and a radio control and sequencing switch to actuate them. Defendant argues that this work should serve as an anticipation under 35 U.S.C. § 102(a). Plaintiff, on the other hand, urges that the classified nature of this work prevented it from being "public" and hence it is not a bar within the meaning of the statute.

It is clear from the evidence that the Dart project was classified in April 1955. Although defendant did present some evidence which would indicate that there was unclassified work on the Dart prior to that time, that evidence consists largely of the oral testimony of one witness. Of all the documentary evidence submitted by defendant in support of this testimony, the only documents that discuss equipping the Dart with flares were post-April 1955 and were classified. On balance, it is concluded that, although defendant has established that the Dart development did occur prior to that of the patentees', defendant has not sustained its burden in establishing a prior public use under 35 U.S.C. § 102(a).[8] *Soundscriber Corp.* v. *United States*, 175 Ct. Cl. 644, 360 F. 2d 954 (1966); *Meurer Steel Barrel Co.* v. *United States*, 74 Ct. Cl. 428 (1932). Moreover, classified documents whose security classification was not removed until after the invention of the patent in suit are not prior publications or evidence of prior knowledge as they are not

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[8] Plaintiff's additional contention that the Dart work was abandoned and is therefore not available as prior art cannot be sustained since it is clear from the evidence that the Dart was successfully reduced to practice prior to the invention of the patent in suit. Its subsequent abandonment in 1957 is irrelevant. *Connecticut Valley Enterprises* v. *United States*, 172 Ct. Cl. 468, 348 F. 2d 949 (1965).

"public" within the meaning of § 102(a). *Minneapolis-Honeywell Regulator Co.* v. *Midwestern Instruments, Inc.*, 298 F. 2d 36, 38 (7th Cir. 1961). Nor are the above principles altered merely because the patentees had a security clearance where, as here, there is no evidence of actual knowledge by the patentees of that prior secret work. *Whitcomb* v. *American Airlines, Inc.*, 164 USPQ 610, 611 (E.D. Va. 1968), *rev'd on other grounds, sub nom General Dynamics Corp.* v. *Whitcomb*, 443 F. 2d 630 (4th Cir. 1971) *cert. denied*, 404 U.S. 1016 (1972); *cf. Ex Parte Stalego*, 154 USPQ 52 (P.O. Bd. App. 1966). The mere fact an individual has a security clearance does not justify the conclusion that he had, or could have had, access to specific secret information. Thus, plaintiff is correct that the Dart work is not a bar under 35 U.S.C. § 102(a).

Nonetheless, the classified documents, and the work on which they are based, do supply probative evidence on the issue of what the general level of skill in the art was at the time the instant invention was made. *Simmonds Precision Products, Inc.* v. *United States*, 153 USPQ 465, 468 (Trial Div. Ct. Cl. 1967). Also see *International Glass Co.* v. *United States*, 187 Ct. Cl. 376, 408 F. 2d 395 (1969); *Servo Corporation of America* v. *General Electric Co.*, 337 F. 2d 716, 720 (4th Cir. 1964) *cert. denied*, 383 U.S. 934 (1966). Further, even though it is not prior art, the work reflected in these documents is some evidence of what those confronted with a similar problem in 1956 would have proposed as a solution to that problem. *Felburn* v. *New York Central R.R.*, 350 F. 2d 416, 425–26 (6th Cir. 1965), *cert. denied*, 383 U.S. 935 (1966). It is in the foregoing light, then, that the Dart target has been considered for purposes of evaluating the § 103 defense.

The Dart target consisted of a lightweight cruciform configuration designed to be towed behind an airplane. Corner reflectors for radar reflectivity were carried on the target. Although originally designed for gunnery, by sometime in 1955, rearwardly disposed flares, ignited sequentially by a battery-powered radio link receiver contained within the nose boom, were used on the Dart target to simulate representative IR emissions characteristic of jet aircraft. The Navy's experiments with the Dart, which included the successful firing of Sidewinder missiles at the flare-equipped target prior to April 1956, demonstrated that flares were an adequate source of IR emissions for purposes of testing air-to-air heat-seeking missiles.

It should also be noted that at about this same time, the Air Force was using flares as an IR source in classified stationary ground tests of heat-seeking missiles. Since this latter work was not "public," it is not available as prior art but it has been considered from the same point of view as the Dart.

The second factor providing some guidance as to the level of knowledge possessed by a person ordinarily skilled in the art is the evidence as to the Air Force Project DOLLAR-WISE brainstorming session, participated in by William Thornton, one of the inventors here, in the early part of 1955. During that session, Thornton was confronted with the problem of evolving a practical scheme that would reduce the cost of heat-seeking missile evaluation and testing and his proposal at that time was to use rearwardly disposed IR sources, possibly *flares*, in an aerodynamically stable tow target. While, again, the evidence regarding Thornton's suggestion does not necessarily establish either a prior invention[4] or a prior publication, it nonetheless has a bearing on the issue of what was obvious in 1956 when Thornton was again presented with substantially the same problem.

In sum, the prior use of radio-actuated flares on targets and the known fact that flares are IR emitters would suggest that there was nothing unobvious in selecting radio-actuated flares as the means for simulating IR emissions on a tow target. The evidence that the patentees and the Navy, both working independently, arrived at the same combination is confirmatory of this conclusion.

With respect to the use of a radio-controlled stepper switch for sequentially igniting the flares, this too had been done previously and was a known technique, although the prior art had done it principally with flares used for visual aids. However, as noted previously, the claims do not support any distinction based on the use to which the flares are put, so the obviousness of the technique for visual-aid purposes is fatal to a claim that is broad enough to cover flares used either for that purpose or another purpose. Moreover, the work on Dart utilized the very same approach, once again confirming the apparent obviousness of the claimed combination.

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[4] Defendant argues that certain sketches produced by Thornton at this brainstorming session constitute a conception of the invention by an employee of the Government, thus barring this suit under 28 U.S.C. § 1498; however, this question need not be resolved in light of the conclusion reached under 35 U.S.C. § 103.

Claims 3 and 4 are directed to the same combination as claim 1 and are considered to be obvious for the same reasons.

Claim 2 differs in substance from claim 1 only in that it specifies elements embedded within the tail fins of the target to form an antenna for the radio receiver. Neither party has placed any emphasis on this feature and it appears to be an obvious expedient. Plainly, the radio receiver requires an antenna and embedding it in the tail fin is one location where aerodynamic drag would be minimized.

The evidence regarding the Dart also is sufficient to invalidate claims 1, 3, and 4 under 35 U.S.C. § 102(g). Under this section, a prior invention, *i.e.*, one that has been reduced to practice and not abandoned, suppressed, or concealed, is sufficient even though it was not "public" at the time the patented invention was made. *International Glass Co.* v. *United States*, *supra.* Here, the evidence is sufficient to establish a reduction to practice of the Dart prior to plaintiff's date of conception, as the oral testimony of defendant's witnesses, and documentary evidence, establishes that flare-equipped, radio-actuated Dart targets were used for successful firing of Sidewinder missiles prior to April 1956.[5] *Corona Cord Tire Co.* v. *Dovan Chemical Corp.*, 276 U.S. 358, 383 (1928); *National Latex Products Co.* v. *Sun Rubber Co.*, 274 F. 2d 224 (6th Cir. 1959), *rehearing denied*, 276 F. 2d 167 (1960), *cert. denied*, 362 U.S. 989. Thus, the only remaining issue is whether the Dart work was abandoned, suppressed, or concealed.

Quite clearly, the abandonment of work on the Dart in 1957 does not remove it as a prior invention against work in April 1956. *Cf. Connecticut Valley Enterprises* v. *United States*, 172 Ct. Cl. 468, 348 F. 2d 949 (1965). The real question is whether, by reason of its classified status, the work must be deemed to have been suppressed or concealed, within the meaning of the statute.

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[5] *Compare, Carboline Co.* v. *Mobil Oil Corp.*, 301 F. Supp. 141 (N.D. Ill. 1969), wherein a 35 U.S.C. § 102(g) defense was unsuccessful because a prior completion and reduction to practice of the invention by another inventor, whose work was under a security classification, was not adequately proved.

The precept that each case involving the issue of suppression or concealment must be considered on its own particular set of facts is a sound one. *Young* v. *Dworkin*, 489 F. 2d 1277 (CCPA 1974); *Myers* v. *Feigelman*, 455 F. 2d 596 (CCPA 1972); *Engelhardt* v. *Judd*, 369 F. 2d 408 (CCPA 1966). There is no one set of circumstances, no one controlling fact that automatically establishes a suppression or concealment. In the final analysis, it is the effect of the particular facts on the primary purpose behind § 102(g), viz, the encouragement of public disclosure of new inventions, that is determinative. As it has been stated, in an interference context, the prior inventor who deliberately suppresses or conceals the knowledge of his invention

> * * * subordinates his claim, in accordance with the general policy of the law in the promotion of the public interest, to that of another and *bona fide* inventor who during the period of inaction and concealment shall have given the benefit of the discovery to the public. Viewed in the light of "the true policy and ends of the patent laws," the latter is the first to invent, and therefore entitled to the reward. * * * [*Thomson* v. *Weston*, 19 App. D.C. 373, 381 (1902). Also, see, *Kendall* v. *Winsor*, 62 U.S. (21 How.) 322 (1858); *Mason* v. *Hepburn*, 13 App. D.C. 86 (1898); *Young* v. *Dworkin*, *supra*.[6]]

It is difficult to view the secrecy imposed on work by a security classification as being hostile to the public good. To the contrary, presumably it is for the public good, as perceived by those in responsible positions of government, that certain types and kinds of work are at one time or another placed in a classified status in which a security clearance is required before anyone is permitted to have access to it. But even then, it frequently is the case that the work itself is intended to be put into use for the public benefit. In other words, the classification restriction may not suppress the work itself, only access to that work. For example, a classified weapon may be manufactured in quantity and placed in the nation's arsenal of weapons, all for the benefit of the public, but yet be kept secret both from the public at large and those working in that same art. In such circumstances, is the Government, which imposed the secrecy order for the public good, obliged to pay compensation to a second inventor who, working independently and without knowledge of the classified article, makes the same invention, but at a later time? Because of considerations such as these, it is believed that the fact of security classification should not be regarded per se as a suppression and concealment; rather, it should be viewed as but one fact in the totality of particular facts applicable to the specific situation under consideration.

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[6] For comprehensive discussions of 35 U.S.C. § 102(g), see, Olsher and Steinhauser, *The Role of the Prior Inventor Under Section 102(g)*, 45 J. PAT. OFF. SOC'Y 595 (1963); Roch, *Prior Knowledge Compared with Prior Invention as a Statutory Bar*, 50 J. PAT. OFF. SOC'Y 409 (1968); Rosenstock, *Prior Art Under 35 U.S.C. Section 103 Includes Prior Invention—In Re Bass Et Al. and In Re Hellsund*, 56 J. PAT. OFF. SOC'Y 263 (1974).

In this case, the evidence established that the information relating to Dart was accessible to at least some of those in the military having security clearances and a need to know. For example, documents in the record indicate that the Navy was keeping the Air Force advised of its Dart program, as well as related matters. Moreover, the Dart equipped with flares was built and actively tested with Sidewinder missiles, thereby demonstrating the feasibility of such a target. The targets subsequently procured by the military, notably those such as the TDU-9/B, are similar in configuration to the Dart and, of course, use the concept of radio-actuated flares. Targets of this type have been used over the years by the military for testing and training purposes. Thus, despite its classified nature, the work on the Dart was not suppressed, in the sense that the benefit thereof was withheld from the public. In the absence of any showing that defendant, by its security classification system, attempted to exclude the public from the benefit of this work, it is considered not to have been suppressed or concealed for purposes of 35 U.S.C. § 102(g). *Cf. Brush* v. *Condit*, 132 U.S. 39 (1889); *Rosaire* v. *Baroid Sales Div., National Lead Co.*, 218 F. 2d 72 (5th Cir. 1955), *cert. denied*, 349 U.S. 916.

Turning to claims 5 through 7, the same combination of a RADop target with radio-actuated flares is claimed, but these claims further include the limitation of a safety switch, which renders the ignitors for the flares inoperative when the target is supported on the towing aircraft. There is no prior art disclosing specifically the use of a safety switch in combination with a target; however, as noted previously, it was well known in the ordnance and armament field to use switches of this type to prevent accidential detonation or ignition. (See finding 7.) Indeed, almost without exception, the Navy requires such safety systems with all of its ordnance. Hence, merely adding a safety switch to prevent inadvertent ignition of the flares is considered to be an obvious expedient.

Claim 7 has added limitation of an insertable pin to hold open the safety switch when the target is on the ground and away from the airplane. Plaintiff has placed no reliance on this feature although the prior art asserted by defendant does not specifically disclose it. Ordnance of the type disclosed in the prior art, to the extent it requires a power source, relies on the batteries of the transporting airplane. As a result, it was generally unnecessary to provide a mechanism to prevent detonation of the ordnance when it was separated from the plane. On the other hand, plaintiff's target has a battery source on the target itself so it is always "armed" in the sense that the power to ignite the flares is present both when the target is supported on the plane and when it is separated from the plane. The safety switch, which is held open by the target support and is therefore effective to prevent ignition when the target is supported on the plane, is ineffective for that purpose when the target is, for example, being handled separately on the ground; thus, the need for an additional mechanism which would disarm the target when it is on the ground. Plaintiff solved this problem by providing a pin that could be manually inserted to hold the normally closed safety switch in an open position.

Considering the level of skill in the art, and in view of the well known need for safety switches and arming devices on all kinds of ordnance, it appears there was nothing unobvious in the safety-pin arrangement specified in claim 7.

In view of the conclusion on validity, it is unnecessary to reach the question of infringement, for an invalid patent cannot be infringed. *Felburn* v. *New York Central R.R.*, *supra*. Nor is it necessary to consider any other of the multiple defenses asserted by defendant in this case.

Claims 1–7 being invalid, the petition must be dismissed.

### FINDINGS OF FACT

**1.** This suit seeks reasonable and entire compensation for the alleged unauthorized manufacture or use by or for the United States of the invention described in claims 1 to 7,[1] inclusive, of United States Letters Patent No. 2,869,120, for "Tow Target Having Combustion Signal Means," issued on January 13, 1959, on an application filed jointly by Orson B. Lolmaugh, William E. Thornton, and Charles A. Smith on September 17, 1956. Del Mar Engineering Laboratories, a corporation incorporated in the State of California, is the owner by assignment of the patent in suit.

**2.** (a) The patent discloses an aerial tow target for simulating self-propelled aerial objects such as jet aircraft for affording practice in detecting, tracking, and intercepting such objects. In use, automatic or semiautomatic equipment such as missiles are fired at these targets as they are towed behind a tractor aircraft. The target is particularly designed to be carried aloft by a tow plane, released and streamed well behind the plane, and recovered by the tow plane before landing, if the target has not been destroyed by a missile fired at it.

(b) A preferred embodiment of the patented device is illustrated in Figs. 1–4 and comprises a streamlined target structure having a low drag aerodynamic configuration formed from a hollow, thin-walled, rigid body, a corner radar reflector incorporated within the body of the tow target, and a plurality of rearwardly directed flares secured in a flare magazine mounted to the trailing end of the tow target body. Carried within the body are a radio receiver and battery to develop an output signal in response to a signal received from a remote signal-generating source and ignitors which may be electrically connected to the battery for igniting the flares. A plurality of fins of a nonmetallic material are carried by the trailing portion of the body member for stabilizing the target in towed flight, and elements are embedded within these fins to form an antenna for the radio receiver. Canted tabs on the fins cause the target to rotate as it is towed.

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[1] The claims are reproduced in the attached Appendix.

(c) The flares are a source of infrared (IR) radiation and are intended to simulate the exhaust of an aircraft engine. While the burning time for most flares is brief but adequate at high missile speeds, the invention provides for timing the combustion period by remote control to occur at a critical or controlling stage in a countermeasure procedure. Further, the patent teaches that a plurality of flares may be mounted on the target, with a sequencing switch for igniting a series of flares in succession to provide a prolonged flame period, or the flares may be ignited at selected stages. To prevent accidental or inadvertent ignition of the flares, a built-in safety system is provided which includes a normally closed switch operable by a safety pin when the tow target is on the ground. The safety system also includes a normally closed switch that opens automatically whenever the target is stored or snubbed on the towing aircraft.

3. Prior to April 1956, aerial targets available for use by various elements of the armed forces included banners, drones, rocket targets, Navy Dart targets, Redbird targets, and plaintiff's DELta targets and RADop targets.

(a) *Banners.*

Polyethylene or cloth banner targets were provided with radar reflectors for rocketry or gunnery practice and were restricted to maximum altitudes, dependent upon the towing aircraft, of about 45,000 feet and airspeeds of approximately 220 knots. They were launched by being dragged from the ground by the towing aircraft. Only short cable lengths (1,000′ to 5,000′) could be used with any degree of reliability. These lengths were sufficient for gunnery and rocketry but insufficient for radar-guided missiles. Banners are relatively high drag targets and are unsuitable for testing heat-seeking missiles since they cannot fly at realistic speeds and/or altitudes and have no source of IR energy.

(b) *Drones.*

Drones are pilotless aircraft, some of which were converted, obsolete airplanes such as the F-80 and B-17. The drone B-17 (*i.e.*, QB-17) was very slow and incapable of meeting the desired test parameters for heat-seeking missiles, having a useful maximum altitude of only about 28,000 feet and a maximum speed of approximately 145 knots, *i.e.*, lower and slower than banners. Further, the QB–17 was driven by four reciprocating engines and was very expensive, having a cost in the area of $1 million each. The QF–80 drone could be flown at approximately 40,000 feet at airspeeds of .6 or .7 mach. It was a jet aircraft having an original cost of up to $1 million each. Smaller drones, designated Q–2 and known as the "Ryan Fire-Bee," cost $200,000 to $300,000. Driven by a jet engine, it could be flown above 40,000 feet and at .6 or .7 mach or slightly faster. This drone originally was unsuitable, in itself, as an IR energy-emitting target for heat-seeking missiles. The use of a drone as a target required at least 100 men and four or five aircraft for each flight. A mother ship had to be in the air to control the flight of the drone; a ground control standby had to be ready in case the mother ship failed; an armed chase plane had to be in the air to shoot the drone down if it went off course; a standby chase plane had to be ready on the ground in case of failure of the chase plane; and, helicopter, boat, and/or truck crews had to be ready to recover the drone if it was not destroyed in flight.

(c) *Rockets.*

Rocket targets were also proposed, comprising small winged rockets which could be fired from an aircraft; soon after, a missile could be fired at the rocket to chase and destroy it.

(d) *Redbird.*

Redbird targets were relatively large, all-metal targets carrying, at one time or another, various equipment including scoring systems, radar and visual augmentation devices, radio receivers, batteries, master switches, etc. Such targets had wingspans of about 18 feet, lengths of about 18.5 feet, and heights of about 7 feet, weighing about 270 pounds unloaded, and capable of carrying up to 500 pounds of payload. They were dragged off the runway. The evidence is unsatisfactory as to when these targets were first used with flares as an IR source.

(e) *DELta targets.*

These delta-winged targets comprised of rigid metal had a wingspan of about 16 feet and a length of about 24 feet, with average weights of 600–1,200 pounds. They were capable of carrying much complex equipment, including batteries, radios, cable releases, parachutes and parachute-deployment equipment, smoke markers, cameras, camera programmers, thermostats, camera heaters, radar corner reflectors, etc. One type of DELta target is illustrated in patent No. 2,898,058. The targets were dragged off the ground by the tow aircraft. In the air, they were towed at a distance of between 1,000 and 1,500 feet behind the tow plane. The DELta targets were released from the tow cable at the end of the mission and were parachuted to the ground for possible recovery.

(f) *RADop targets.*

The early RADop targets were relatively lightweight (18–36 pounds), about 18 inches in diameter, and about 100 inches long. They were carried aloft by a tow aircraft, streamed behind the tow plane a suitable distance for gunnery or rocketry shooting, and could be recovered, in some cases, by being reeled into the tow plane. The target was provided with one or more corner reflectors for radar reflectivity. Some of the earliest designs of targets of the RADop series are described in plaintiff's patent No. 3,137,852.

Another version of the RADop target appears in patent No. 3,128,463, filed December 28, 1955. That target has a hollow, streamlined body member of an aerodynamically stable configuration, an internally mounted radar corner reflector unit, and cambered fins at the rear end thereof to produce, as the target is towed, a uniform velocity of rotation of the target about its longitudinal axis.

Patent No. 3,010,103 describes another version of the RADop target employing a number of large and small corner reflectors to provide mono-static and bi-static radar reflection.

None of the RADop targets, prior to the flare target disclosed and claimed in the patent in suit, employed, utilized, or provided a source of IR energy or any type of control or power system thereon.

Plaintiff's RADop targets were offered for sale to the Air Force in July 1955. These carried a corner radar reflector of the type shown in the patent in suit. The body of the target was radar permeable, it spun as it was towed, and it was identical in shape to the target structure shown in the patent in suit.

(g) *Navy Dart.*

In late 1953 or early 1954, the Dart target was developed by the Naval Ordnance Test Station at China Lake, California. As illustrated in patent No. 2,978,700, it was of a plywood cruciform configuration with a metal nose, measured about 12 feet long and weighed about 100–150 pounds. It employed a corner reflector for radar reflectivity. Initially, the Dart was snatch-launched and used for gunnery and rocketry system evaluations. If the target was not expended during a flight, it was parachuted to the ground and a search crew was sent out to pick it up. One air launch of the target was attempted but was deemed to be unsuccessful and this method was abandoned.

By the early part of 1955, the Dart target had been used as a ground-to-air towed target for antiaircraft and guided missiles and in experimental tows for air-to-air guided missiles. In early April 1955, it was proposed to incorporate a radio link in the nose of the target to actuate smoke generators and flares on the target to aid visual identification and for tracking of the target.

On April 26, 1955, the Bureau of Aeronautics directed the Naval Ordnance Test Station (NOTS) to institute a program for developing a suitable tow target system for guided misssile development, evaluation, and training. The Dart-type target was the principal focus of the program and one objective was to develop a suitable IR source for that target. The program was classified "Confidential-Security Phase C3."

The early work under this program involved an evaluation of the target's high-speed capabilities and the use of radio-actuated smoke generators for visual aids. By July 1955, orders had been placed for radio-link receivers to use for command operation of IR-signal sources on the target. The IR sources used, as of July, included flares fired sequentially by radio command and a propane stove. Sidewinder missiles were successfully fired at these targets and both IR sources were considered to be adequate. It was also proposed to use an air-turbine-driven generator to power an electrical heating element.

By April 4, 1956, the work under this program involved an investigation of various kinds of flares and launch techniques. On April 9, 1956, NOTS advised Eglin Air Force base of the work it had been doing on flare-equipped Dart targets and described the towing techniques employed with it. The report described the work as "only limited experimental use and has not been employed at altitudes over 10,000 feet."

The documentary evidence in the record confirms that heat-seeking missiles had been fired at flare-equipped Dart targets prior to April 1956 and that the use of flares as an IR source on the Dart target had been contemplated prior to that time. The first specific mention of the use of flares as an IR source on a Dart target appears in a classified document dated July 8, 1955. References to the firing of Sidewinder missiles against Dart targets equipped with flares as an IR source are contained in documents dated July 8, 1955, April 4, 1956, April 9, 1956, and November 20, 1957, all of which were classified at the time.

The Navy's experiments with the Dart demonstrated that the flares were an adequate source of IR emissions for purposes of testing air-to-air heat-seeking missiles; however, the experiments, which continued into 1957, revealed that the aerodynamics of the Dart target were such that it could not be towed at the requisite speed and distances. In a report dated November 20, 1957, it was recommended that further work on the Dart as a target for air-to-air missiles be abandoned. This project, and the results thereof, remained classified well beyond 1956.

4. It is important that a target be towed at sufficient distances behind the towing aircraft to avoid any possibility that the missile fired at the target will, instead, lock on and hit the airplane. The distances at which the DELta targets could be towed rendered them wholly inadequate as a heat-seeking missile target. The Dart target suffered from this same defect but it was still used with heat-seeking missiles by having the tractor airplane execute a 180° turn as the firing occurred so that it was flying in a direction opposite to the target and

thereby did not present an alternate IR target for the missile.

5. The June 1955 issue of COMMUNICATIONS AND ELECTRONICS DIGEST, a classified periodical published by the Air Force, reported the use of flares as a source of IR radiation in stationary ground tests of heat-seeking missiles. Flares were also commonly used in 1955 as photographic tracking aids. For the purpose of tracking and photographing, the Air Force employed radio-actuated flares as early as March 1954 on drone targets at Holloman Air Force Base. As early as about October 1954, radio-actuated flares were mounted on drone aircraft used by the Navy as targets for heat-seeking missiles. These Navy drones had a plug receptacle into which was installed an arming plug prior to launch of the drone. There was also another switch that could be used to interrupt the initiating circuit for each set of flares. Sequencing switches were used to control the order of ignition of the flares on command from the ground. The flares were used as a visual aid.

6. Neither the use of flares as a tracking technique nor the drones equipped with flares were security classified; however, the projects in which these were used were classified.

7. Prior to 1956, the use of safety switches on ordnance carried aboard aircraft was conventionally used by those skilled in the ordnance art. Safety switches were, and are, used for bombs, rockets, or any other type of ordnance. For years, almost all naval aircraft that are aboard carriers have been equipped with a safety switch which disarms or disables all ordnance. One type of switch that has been connected to the landing gear so that when the plane is resting on the gear, the switch is effective to disarm the firing circuitry. The patent of Menke et al, No. 2,880,672, discloses a safety switch where the physical movement of a droppable item on an aircraft affects the closing of a circuit thereby to arm the munition or ordnance. This switch serves to make it impossible for the ordnance to explode on the launching apparatus, for the fuse cannot be armed as long as the projectile has not traveled a given distance from the launch craft. Bianchi patent, No. 2,853,010, also shows the use of a safety switch which opens a circuit and arms a bomb mounted

on the aircraft, this circuit remaining open until the bomb is released. This patent discloses a breakaway plug connected on one side and to a source of electrical energy on the other. The safety switch is disposed in a well or recess in the bomb casing and the source of electrical energy is a battery or the like carried aboard the aircraft. When the bomb is placed on the bomb rack of the aircraft and "plugged in," its fuses are electrically energized and the bomb is activated. Its fuses do not become armed, however, until the plug is disconnected upon release, when the bomb has traveled a predetermined distance from the aircraft.

In addition to the above, prior to the time the invention was made, short lanyards were in common use to actuate and arm bombs only upon release from aircraft. This is shown, for example, by the AERO 9A EJECTOR BOMB RACK ASSEMBLY (DX–7).

8. Notwithstanding these prior art devices, immediately prior to the time the invention was made, the Air Force was in need of a tow target that could be used to test its then-new heat-seeking missile. Col. Roy Meyers, who was in charge of searching for an adequate tow target to accomplish that purpose, testified that, after extensive research on his part, he was unable to find, in 1955 and early 1956, any system capable of simulating the high speed of jet aircraft while at the same time producing the IR emission necessary for attracting heat-seeking missiles. He further testified that the use of drones was prohibitively expensive and that it was not until plaintiff's flare-equipped tow target came on the scene that the problem was solved. Col. Meyers was not aware of the Dart work but testified that the distances at which that target could be towed would have rendered it unsuitable for Air Force use.

9. William Thornton was an officer in the United States Air Force from 1952 to 1954. His main assignment while stationed at Eglin Air Force Base was in the field of instrumentation which included problems in the instrumentation of tow targets. In 1954, he was officer in charge of the photo optics section of the range instrumentation branch. After discharge from active military service in 1954, Thornton remained on at Eglin A.F.B. until July 1955 in a Civil Serv-

ice position as a physicist and consultant, in order to continue his work in the field of instrumentation.

**10.** In 1955, while at Eglin A.F.B., Thornton witnessed flights of drones which were completely radio-controlled and which carried a TV camera aboard to transmit to the mother ship a picture of the instruments. He also saw films taken at Holloman A.F.B. of the firing of IR or heat-seeking missiles at the hot engine exhausts of B–17 bomber targets. He also witnessed the use of visual augmentation flares on air-to-air missiles as photographic aerial tracking aids.

**11.** In 1955, the Air Force funded an ad hoc committee designated Project DOLLAR-WISE, having the responsibility of developing a practical scheme that would reduce the cost of missile evaluation and testing. During the meeting of Project DOLLAR-WISE attended by Thornton in the early part of 1955, he made a sketch which showed one or more tow targets—in general form—streamed a relatively short distance behind a QF–80 drone. A dot was put on the tail of the target with radial lines around it to represent a source of radiant energy. These tow targets were to be towed by a drone which was reusable; the target itself could be destroyed. Flares were proposed as an IR source and were mounted on the tail of the target. During that session there were discussions of how to actuate such a device, including putting it through intermittent G-loads, changing altitudes, radar-actuation, etc. The committee took no action on this proposal and Thornton did nothing further with it.

**12.** After leaving Air Force employment, Thornton was employed at the University of North Carolina medical school in developing medical electronic instrumentation. Then, in April 1956, he agreed to work for plaintiff. While traveling to California from North Carolina, Thornton stopped at Eglin A.F.B. and spent several days there visiting friends and reacquainting himself with the state of the art and current problems in scoring systems for targets, one of the areas in which he was to work for plaintiff. While at Eglin, Thornton discussed a problem that the Air Force was experiencing in having no satisfactory system against which to test heat-seeking missiles. This problem was discussed with a representative of plaintiff, Neil Lamont, and Col.

De Jarnette, USAF. It was at this meeting that Thornton conceived the basic idea of the tow target disclosed in the Lolmaugh et al. patent. Thornton's concept included the use of flares on a high-speed, low-drag, lightweight, streamlined target which, by means of chemical energy, could release very large amounts of IR energy for short periods of time, and use of some means of triggering the flares so that the energy was available only when it was needed during the tracking phases. In essence, his idea included the use of a lightweight, high-speed, low-drag target that could be mounted on a high-performance aircraft, launching it to a distance of many miles behind the tow aircraft and recovering the target by a method such as that employed with plaintiff's early RADop targets.

**13.** Thornton explained his concept to Lamont, who was enthusiastic about it. Upon his arrival at plaintiff's plant in April 1956, Thornton again discussed the problem and his proposed solution. He was assigned to work under Orson B. Lolmaugh on a crash program to conduct a feasibility demonstration of a flare target system. Thornton also worked with Charles A. Smith on the program. Several freehand sketches were made during initial discussions between Thornton, Lolmaugh, and Smith to determine that the concept could be employed, and of suitable hardware. Since plaintiff already had a basic target body in its early RADop series, as well as a tow-reel system capable of streaming targets a considerable distance behind a tow aircraft, Thornton, Lolmaugh, and Smith proposed to utilize these existing devices to demonstrate a flare target at the lowest possible cost and in the least possible time. They recommended that actual work be undertaken and a job authorization was issued on May 3, 1956, so work could begin on the first prototype.

**14.** Under the direction of Thornton and Lolmaugh, Smith produced the first formal drawing, illustrating the features of an assembled flare target as proposed on May 4, 1956. The three inventors then undertook work to design and/or procure suitable equipment including radios, batteries, escapement-switching devices, flares, etc. These elements were then mounted in an early-series RADop target to produce a flare target of the type illustrated and described in the patent in suit. Within a matter of weeks, a flare target had been prepared by plaintiff and it was then mounted on a Cessna aircraft, using an already available Del Mar launcher and tow reel. The aircraft was then flown offshore at El Segundo, California, with Lolmaugh serving as the tow-reel operator in the plane. With the target streamed behind the aircraft, the flares were ignited one at a time by Thornton via radio command from the beach. Thereafter, the target was recovered. The initial flight test having been completed, detailed drawings were prepared and several additional flight tests were conducted to experiment with and select suitable flare-mounting structures and arrangements as well as to test various flare-firing combinations. These tests indicated that the target configuration was not optimum because the flares disturbed the airflow over the target and that parasitic ignition of the flares could occur. As a result of subsequent work by plaintiff, and some tests later conducted by the Air Force, the target was refined and modified to its final commercial form. That form has the same basic body shape as that disclosed in the patent and includes fins, radio equipment, power supply, stepping relay, flares, and radar equipment, all as disclosed in the patent in suit.

**15.** On August 17, 1956, the Air Force, through its Base Procurement Office at Eglin A.F.B., entered into supply contract No. AF 08(603)-3163 with plaintiff, to purchase various items, including ten targets of the type disclosed in the patent in suit. Upon delivery of some of the targets, a T-33 aircraft was used for streaming at least one of the flare targets on several flights; another T-33 was used for photographing the streaming and flare ignition on at least one of the flights. As a result of these acceptance flights, the targets were accepted and the remaining targets were delivered to the Air Force.

**16.** Substantial quantities of these targets have been sold both to the United States and to foreign governments. Subsequent to plaintiff's development, others in the field have developed tow targets of a similar construction using radio-actuated flares as an IR source, including those accused to infringe. The TDU-6/B target procured by defendant has a configuration similar to that of the RADop target, while the TDU-9/B target is similar in shape to the Dart target. Others of the targets procured by defendant have no physical resemblance to either the RADop or the Dart; however, they all are towed targets with radar reflectivity (active or passive) and radio-actuated flares.

### CONCLUSION OF LAW

Upon the foregoing findings of fact and opinion, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is dismissed.

## APPENDIX

1. An aerial tow target comprising a hollow thin-walled rigid body member having a low drag aerodynamic configuration, the walls of said body member being formed of a non-metallic material permeable by radar waves; means defining a plurality of normally intersecting planes interiorly of said body member and having a metallic surface for reflecting exteriorly propagated radar waves; a rearwardly directed flare magazine mounted to the trailing end of said body member; a plurality of rearwardly directed flares mounted in said magazine; a radio receiver carried within said body member, said radio receiver developing an output signal in response to a received signal from a remote source; and means for igniting said flares in sequence, including means responsive to said output signal of the radio receiver, whereby said flares are ignited in response to the received signal from the remote source.

2. An aerial tow target comprising a hollow thin-walled rigid body member having a low drag aerodynamic configuration, the walls of said body member being formed of a non-metallic material permeable by radar waves, means defining a plurality of normally intersecting planes interiorly of said body member and having a metallic surface for reflecting exteiorly propagated radar waves, a rearwardly directed flare magazine in the trailing end of said body member; a plurality of rearwardly directed flares mounted in said magazine; a radio receiver carried within said body member, said radio receiver developing an output signal in response to a received signal from a remote source; means for igniting said flares in sequence including means responsive to said

output signal of the radio receiver whereby said flares are ignited in response to the received signal from the remote source; a plurality of fin elements carried by the trailing portion of said body member for stabilizing the same in towed flight; said fins being formed of a non-metallic material; and elements embedded within said fin elements forming an antenna for said radio receiver.

3. An aerial tow target for practice in the detection of self-propelled aerial objects, comprising: a streamlined body; means carried by the leading end of said body for connection to a tow cable whereby said target may be towed by an aircraft to which said cable is affixed; a rearwardly directed flare holder mounted to the trailing end portion of said streamlined body; at least one rearwardly directed flare mounted in said holder; a radio receiver carried within the body of the tow target, said radio receiver developing an output signal in response to a signal received from a remote signal-generating source; and means for igniting said flare, including means responsive to said output signal of the radio receiver, whereby said flare is ignited in response to the received signal from the remote signal-generating source during the tow of the target.

4. An aerial tow target, comprising: an elongate, streamlined body member for connection to a tow cable for tow by an aircraft to which said cable is affixed; a rearwardly directed flare holder mounted to the trailing end of said body member; a rearwardly directed flare mounted in said holder; a radio receiver carried within said body member, said radio receiver responsive to a received signal from a remote source for developing an output signal; an electromotive source carried by said body member; electro-responsive means carried within said body member for igniting said flare; and means responsive to the output signal of said radio receiver for electrically coupling said electromotive source to said electro-responsive ignition means for actuation of the same, thereby to ignite said flare in response to the received signal from the remote source.

5. An aerial tow target for practice in the detection of self-propelled aerial objects, comprising: a streamlined body for connection to a tow cable; at least one charge of rapidly combustible material carried by said body to create a highly

visible flame; remotely controlled ignition means on said body to ignite said charge; means for supporting said body on an aircraft for transportation to a practice area; and safety means to make said ignition means inoperative in response to engagement of the body by said supporting means.

6. An aerial tow target for practice in the detection of self-propelled aerial objects, comprising: a streamlined body for connection to a tow cable; at least one charge of rapidly combustible material carried by said body to create a highly visible flame; a radio receiver carried by said body; an electromotive source carried by said body; electrical means to ignite said charge; means responsive to said radio receiver to place said source in electrical communication with said ignition means; means for supporting said body on an aircraft for transportation to a practice area; and safety switch means responsive to engagement of the body by said supporting means to render said igniting means inoperative.

7. An aerial tow target for practice in the detection of self-propelled aerial objects, comprising: a streamlined body for connection to a tow cable; at least one charge of rapidly combustible material carried by said body to create a highly visible flame; a radio receiver carried by said body; an electromotive source carried by said body; electrical means to ignite said charge; means responsive to said radio receiver to place said source in electrical communication with said ignition means; safety switch means to make said igniting means inoperative when the tow target is on the ground; and a safety operating member for insertion into said body to actuate said safety switch means.

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524 F. 2d 668

## FRANKLIN E. PENNY COMPANY v. THE UNITED STATES

[No. 433-73. Decided October 22, 1975]

### OPINION

**Contracts; default termination; Government-approved manufacturers; unavailability of named manufacturers; termination of contract before approval of new manufacturer; substantial per-**

**formance; Federal Assignment of Claims Act; counterclaims; small business set-aside supply contract.**—The United States issued a small business set-aside solicitation seeking bids for the manufacture of shock mounts for Terrier missile containers, four approved manufacturers for the bonding of metal parts to rubber being named in the contract documents. Government approval of other manufacturers than those named was required. Before contract award, plaintiff ascertained that one of the companies named had done such bonding and plaintiff was given a quotation for the work, but no direct inquiry was then made by plaintiff as to whether and within what time frame the named company was willing to undertake the job. Plaintiff submitted its bid to the Government and was awarded the contract, performance being due within 90 days from award. A month after the award, plaintiff sought the bonding manufacturer's services but was informed that the latter was not tooled to produce the item at that time; of the other approved manufacturers, two were no longer in business and the fourth was not interested because the job was too small and delivery time too short. Although extensions of time were granted, plaintiff was not successful in locating a satisfactory manufacturer within the contract period, and the contract was terminated for failure to make timely delivery. The Armed Services Board of Contract Appeals sustained the termination, concluding that in order for plaintiff to escape the consequences of a default termination it would have to be shown that the failure to deliver had been due to causes beyond the control and without the fault or negligence of itself or its subcontractor, that this burden had not been met, that the cause of the default was the subcontractor's delay and its technical inability to complete the work on time, and that the subcontractor's inability was a cause for which both plaintiff and its subcontractor took responsibility. It is *held* (1) that the conclusion of the Board was correct; (2) that, fairly construed, the contract language does not warrant that the named manufacturers will do the job, only that they can do it, and no breach of contract may be imputed to defendant because the named manufacturers declined to undertake the work; (3) that the obligation to locate a supplier was upon plaintiff; (4) that defendant's termination of the contract before plaintiff was in a position to submit work for approval was not a breach of contract, since termination, though effected before approval had been accomplished, occurred after plaintiff had failed to meet the promised delivery date; (5) that the substantial performance doctrine is inapplicable here since the additional time which plaintiff projected for completion went beyond what defendant could justifiably be required to accept in the name of substantial performance; (6) that defendant's counterclaim demands relating to transactions independent of the subject matter of the present dispute were properly raised here; and (7) assuming the existence of the claimed assignment of contract proceeds, that the protection against a diminution in contract proceeds afforded by 31 U.S.C. § 203 and 41 U.S.C. § 15 is a limited benefit and one that runs exclusively to the assignee and may not be extended to bar the United States from obtaining a judgment in an amount independent of what might otherwise be found owing the assignee. Plaintiff's motion for summary judgment is denied, defendant's cross-motion is granted, the petition is dismissed, and judgment is entered for defendant on its counterclaims against plaintiff in the sum of $58,992.94.

**Contracts; termination; default termination; delay in deliveries; subcontractor problems.**

[1] Where plaintiff failed to deliver supplies within the extended delivery time, and the delay experienced by plaintiff in obtaining rubber bonding by a subcontractor was not due to causes beyond the control and without the fault or negligence of plaintiff or its subcontractor, a termination for default is proper within the intendment of the contract's default clause.

United States ⚷ 72(7)

**Contracts; warranty; approved sources of supply; warranty of ability to do work.**

[2] Where the Government issues a contract drawing upon which are listed the names of Government-approved sources of supply, this constitutes only a warranty by the Government that the listed suppliers have the *ability* to do the work and not a warranty of their willingness to do the work whenever a demand for the service might materialize within the contemplated time period. A warranty which would place upon the shoulders of the United States the burden of guaranteeing performance of third parties without regard to any fault of its own is an assumption of responsibility that should not be inferred from ambiguous, inconclusive or general discussions.

United States ⚷ 70(30)

**Contracts; breach; approved sources of supply; unavailability to do work.**

[3] Breach of contract may not be imputed to the United States simply because the manufacturers that it had listed in the contract documents as approved sources of supply declined to undertake the work for which they had been found qualified.

United States ⚷ 73(22)

**Contracts; breach; default termination; Government approval of subcontractor; failure to make timely delivery.**

[4] Where the Government has specified that certain work required by a supply contract may only be done by an approved source and where all the approved sources listed in the contract documents are found by the contractor after contract award to be unavailable, the latter is entitled to time extensions sufficient to permit locating a new supplier and securing the Government's necessary approval. However, a subsequent termination of the contract for default be-

cause the contractor failed to meet the promised delivery date is not a breach of contract even though the termination was effected before approval of a new supplier. Contractor-caused delays in timely submitting a product for approval expose the situation to the same risks of termination as would attend the failure to make timely deliveries once approval had been given. In either case, the sufficiency of the contractor's performance is to be measured by the dates specified in the contract; where delinquencies occur which are not excusable, termination for default is within the Government's rights.

United States 🔑 72(7)

**Contracts; performance; substantial performance.**

[5] Substantial performance refers to the equitable doctrine that guards against forfeiture in situations where a party's contract performance departs in minor respects from that which had been promised. Save in situations where time is of the essence, the timeliness of a contractor's performance is as much a factor to be considered in evaluating the substantiality of that performance as are all other factors which might bear upon the adequacy of completeness of that performance. The doctrine should not be carried to the point where the non-defaulting party is compelled to accept a measure of performance fundamentally less than had been bargained for.

Contracts 🔑 294

**Contracts; performance; substantial performance; supply contracts.**

[6] The doctrine of substantial performance is not limited in its application to a supply contract situation to only those situations where the contractor has delivered the goods on schedule.

Contracts 🔑 294

**Pleading and practice; motion for summary judgment; administrative decision, opposition to; specificity.**

[7] Under this court's Rule 163(b)(3)(ii), on each error of law cited the memorandum or brief in support of a motion for summary judgment shall state the reasons for the challenge of the administrative decision, cite the authorities relied upon and state the conclusion of law deemed warranted by the citations. It is the function of the attorney and not that of the court to point out errors with specificity. This rule is the same whether the error claimed is one of fact or of law.

Courts 🔑 470

**Court of Claims jurisdiction; counterclaims; unrelated transactions.**

[8] Under 28 U.S.C. § 1503 the Court of Claims has jurisdiction to render judgment upon any set-off or demand by the United States against any plaintiff in this court, and pursuant to Rule 40(b) the United States may state as a counterclaim any claim against a plaintiff not arising out of the transaction or occurrence that is the subject matter of the petition. In the present instance, it is of no consequence, therefore, that the counterclaim demands of the United

**States relate to transactions totally independent of the administrative record made before the administrative board.**

Courts 🔑 450

**Counterclaim; Government's claim re unrelated transactions; extent of contractor's and assignee's liability.**

[9] **Assuming the existence of a bona fide assignment under the Federal Assignment of Claims Act, any recovery of the contract proceeds covered by that assignment would be afforded statutory protection against reduction or set-off on account of transactions arising independent therefrom. However, this protection against a diminution in contract proceeds is a limited benefit and one that runs exclusively to the assignee, and may not be extended to bar the United States from obtaining a judgment, in an amount independent of what might otherwise be found owing the assignee, running exclusively against the contractor and based upon transactions unrelated to the cause of action sued on. Thus, while contract sums earmarked for an assignee are not subject to set-off or reduction on account of unrelated transactions, a contractor who sues to recover such sums in behalf of the assignee is properly subject to counterclaim demands that arise from unrelated transactions.**

United States 🔑 130(4)

*Frederick D. Sarkis*, attorney of record, for plaintiff.

*Alan L. Ferber*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

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Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

PER CURIAM: This case comes before the court on defendant's motion, filed June 12, 1975, pursuant to Rule 141(b) [but deemed to have been filed under Rule 54(b)(iii)], requesting that the court adopt the recommended decision of Trial Judge John P. Wiese*, filed April 28, 1975, pursuant to Rule 166(c) on plaintiff's motion and defendant's cross-motion for summary judgment, since plaintiff has failed to file a timely request for review by the court of the trial judge's recommended decision. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, as hereinafter set forth, it hereby affirms and adopts the same as the basis for its judgment in this case. Therefore, plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted, plaintiff's petition is dismissed and judgment is entered for defendant on its counterclaims against plaintiff in the sum of $58,992.94.

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* The necessary facts are stated in the opinion.

### OPINION OF TRIAL JUDGE

WIESE, *Trial Judge:* This is an appeal from a decision of the Armed Services Board of Contract Appeals (hereinafter the Board) sustaining the Government's default termination of plaintiff's supply contract.[1] The appeal, presented here in the conventional format of a motion for summary judgment, asserts that the administrative decision is not entitled to finality under the Wunderlich Act[2] first, because it reflects alleged errors of law and second, because it includes factual findings that are said to be lacking in substantial evidentiary support. The United States denies these claimed deficiencies in the Board's decision and insists that the decision is entitled to full finality. In addition, the United States has interposed, by way of counterclaims, a demand for judgment in the amount of $58,992.94. This demand represents the aggregate of excess reprocurement costs that were incurred by the United States in consequence of its reletting of 14 separate contracts upon each of which plaintiff had been default terminated.

Upon a review of the record and notwithstanding some equities in its favor, the conclusion must be reached that plaintiff cannot prevail. The administrative decision is entitled to full finality and the United States is entitled to judgment on its counterclaims.

### *I. The Essential Facts*[3]

On May 8, 1969, the United States, acting through the Navy Ships Parts Control Center in Mechanicsburg, Pennsylvania, issued a small business set-aside solicitation seeking bids for the manufacture of 96 shock mounts for Terrier missile containers. The shock mounts, which were to be fabricated in accordance with the specifications contained in a

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[1] *Franklin E. Penny Co.*, ASBCA No. 15229, 71-2 BCA ¶ 9159 [hereinafter cited as 71-2 BCA].

[2] 68 Stat. 81, 41 U.S.C. §§ 321-22 (1970).

[3] Unless otherwise indicated, the facts given are drawn from those found by the Board or else represent uncontroverted facts.

1965 drawing, included a subassembly that required the bonding of rubber blocks to metal plates. Relevant to this bonding requirement was a recitation on the drawing which stated as follows:

> The following manufacturers are approved for the bonding of the metal parts to the rubber.
>
> 1. Lord Manufacturing Company, Erie, Pa.
> 2. Dow-Elco Inc., Montebello, California
> 3. Henrite Products Corporation, Ironton, Ohio
> 4. Goodyear Tire and Rubber Company
>
> Other manufacturers wishing to bond the rubber parts shall contact the Navy Bureau of Ordnance, Washington, D.C. for approval. [ASBCA Record, Appellant's Exhibit A-1, Contract Drawing, Shock Mount Sub-Assembly.]

Upon receipt of this solicitation, the contractor contacted various potential suppliers to ascertain prices and delivery times. Among the companies thus contacted was the Lord Manufacturing Company, the first of the four companies that had been listed on the contract drawing as a Navy-approved source of supply for the bonding requirement. This initial contact with the Lord Manufacturing Company was by way of a telephone call between plaintiff's president and a Lord salesman and, in the course of their telephone conversation, plaintiff was informed that the company had often done the bonding operation in the past. At the time, plaintiff asked for and was given a bonding quote of $12 per unit. However, it does not appear from the testimony that anything more than this was ascertained, that is, the question of delivery was not discussed. On this same point, the Board found "that the latter [meaning plaintiff's president] made no direct inquiry as to whether and within what time frame Lord Manufacturing Company was willing to undertake the bonding job and that he considered the salesman's willingness to quote a price as implying willingness on Lord's part to perform the work when given a definite order * * *."[4]

Following this telephone conversation and being then otherwise satisfied that it could properly accomplish the work, the contractor submitted a bid and was awarded the contract in the latter part of June 1969. Under its terms full performance was due within 90 days from the award, or, in this instance, by September 15, 1969. The total amount of the contract was $33,600.

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[4] 71-2 BCA at 42,478.

Approximately one month after the contract award, the contractor forwarded a purchase order to Lord Manufacturing Company asking that it undertake to do the bonding work that the contract required. Within a week thereafter, on July 30, 1969, Lord Manufacturing responded saying that it was not then tooled to produce the item and would therefore not be competitive; hence, the order was declined. Thereupon, the contractor turned to the other Navy-approved suppliers and learned through the inquiries that followed that of the three remaining listed companies, two—Henrite Products Corporation and Dow-Elco Inc.—were no longer in business, while the third, Goodyear Tire and Rubber Company, was not interested in the work because the job was too small and the delivery time too short. Other companies were then sought out but without timely success.

Because of this difficulty, the contractor found it necessary to request a time extension. On September 4, 1969, plaintiff's president addressed a letter to the Defense Contract Administrative Services Region (DCASR), Philadelphia, Pennsylvania, which asked for an extension of the contract's delivery date to December 15, 1969. This request was granted. In the letter asking for the extension, no mention was made of the bonding problem. Instead, the contractor referred to his problems as "machining difficulties." In his testimony before the Board, the contractor explained that use of the term "machining difficulties" had been suggested to him by a DCASR employee whose function it was to monitor the status of the contractor's production and who, in the pursuance of these duties, visited the contractor's plant on a weekly basis and was thus aware of the problem that had been encountered with respect to locating a subcontractor for the bonding work.

The effort to locate a satisfactory bonding source was continued. Although the Board made no finding on the point, it appears that of the numerous companies that were contacted during this extension period, those that did express an interest in doing the bonding work demanded more lead time than plaintiff felt could be allowed. At any rate, it was not until the end of November or early December that plaintiff located an acceptable bonding subcontractor. This company, the Alpha Rubber Company, advised plaintiff that it would need about 5 weeks in which to make the necessary mold and from this to produce the necessary parts.

On January 8, 1970, plaintiff again wrote DCASR to request extension of the contract's delivery date—this time until February 1, 1970.[5] Machining difficulties were once more cited as the reason for the requested extension and again plaintiff explained that his use of this reason for extension was prompted by the suggestions made to him by the DCASR representative.

Alpha's initially projected 5-week delivery period did not materialize. That company experienced problems in the making of the mold and this, in turn, made impossible plaintiff's completed performance by the anticipated date of February 1, 1970.

Accordingly, on February 3, 1970, plaintiff forwarded a third request for extension to DCASR. In this letter, plaintiff for the first time mentioned that it was "having difficulty in obtaining delivery of the rubber bonding on parts for this contract * * *." An extension until March 1, 1970, was requested.

On February 19, 1970, the Government responded to the contractor's two pending requests for additional time. (The January request had not previously been acted upon by the Government.) On this date, it issued amendment 2 to the contract extending the contract's delivery date from the then existing but obviously no longer controlling due date of December 15, 1969, to the most recently requested date that had been specified by the contractor, namely, March 1, 1970.

The contractor did not perform by the promised date of

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[5] The record offers no explanation, by way of testimony or otherwise, concerning the period between December 15, 1969—the terminal date of the contract under the first extension—and January 8, 1970, the date the contractor wrote to request his second time extension. Presumably, this hiatus was a period of inactivity for both parties. The Government seems not to have raised any questions regarding the contractor's tardiness in performance and the contactor, in turn, took no timely steps to secure a necessary second extension.

March 1, 1970. Accordingly, on March 2, 1970, the contracting officer wrote to advise plaintiff that, if delivery had not been made in accordance with the March 1, 1970 date, then the contract would be carried in a delinquent status until March 12, 1970. At the same time, the contractor was asked to present in writing, within 10 days, any reasons that might establish that the failure to perform had been due to reasons beyond the contractor's control and without his fault or negligence.

The contractor responded on March 7, 1970. The answer given the Government reads, in part, as follows:

> When we first quoted this job there were three names of companies given who were qualified to do the rubber bonding on this job. I got a price to quote from one of them on the telephone. After I received the contract I found that one of the companies named on the print was out of business and the other two felt that the job was too small to bother with.
>
> The problem is that we had difficulty finding someone who would agree to do the bonding. After we found a company to do the bonding we were held up on the molds for 12 weeks before the bonding could begin. [ASBCA Record, Rule 4 Doc. No. 5.]

The letter goes on to recite that, but for the problem with the molds, delivery would have been accomplished sometime in January and that "[a]s of now the bonding is being done and we will ship this job by the end of March." The contracting officer did not consider the contractor's response to be sufficient to preclude termination for default; by letter of March 20, 1970, the contract was so terminated.

## *II. Discussion*

A. *Plaintiff's Claim:* In its decision the Board said that in order for the contractor to escape the consequences of a default termination it would have to be shown that the failure to deliver had been due to causes beyond the control and without the fault or negligence of itself or its subcontractor. In the Board's view of the case this burden had not been met. The cause of the default, as the Board saw it, was the subcontractor's delay, and as to this cause it was observed that "the record contains neither detailed explanation of its [the subcontractor's] delay nor a showing that it was due to any cause other than Alpha's technical inability to complete the work on time."[6] Such a cause, said the Board, "is one for which both appellant and its subcontractor must take responsibility."[7]

The Board was correct both in its view of the law as well as in its application to the facts of the case. The default clause in plaintiff's supply contract[8] gave the Government the right to terminate the contract either in whole or in part if the contractor failed to make delivery of the supplies within the time specified in the contract or any extension thereof. The existence of "excusable" causes for delay or nondelivery would, of course, require converting a default termination into a termination for the Government's convenience (see paragraph (e) of the "Default" clause, *supra* note 8). However, subcontractor delays of the sort experienced here do not excuse a prime contractor's delinquencies. *See Poloron Products, Inc.* v. *United States*, 126 Ct. Cl. 816, 828, 116 F. Supp. 588, 595 (1953), and *Putnam Mills Corp.*, ASBCA No. 5548, 60–1 BCA ¶ 2511. Indeed, plaintiff does not challenge the Board's decision on this ground. Instead, the arguments that are raised look not to excuse the contractor's delivery failure; rather, they seek to place the responsibility for the default squarely upon the Government's shoulders.

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[6] 71-2 BCA at 42,480.

[7] *Id.*

[8] The Default Clause in the contract reads in part as follows:

"(a) The Government may, subject to the provisions of paragraph (c) below, by written notice of default to the Contractor, terminate the whole or any part of this contract in any one of the following circumstances:

"(i) If the Contractor fails to make delivery of the supplies or to perform the services within the time specified herein or any extension thereof; or

"(ii) If the Contractor fails to perform any of the other provisions of this contract, or so fails to make progress as to endanger performance of this contract in accordance with its terms, and in either of these two circumstances does not cure such failure within a period of 10 days (or such longer period as the Contracting Officer may authorize in writing) after receipt of notice from the Contracting Officer specifying such failure.

* * * * *

"(c) Except with respect to defaults of subcontractors, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises out of causes beyond the control and without the fault or negligence of the Contractor. Such causes may include, but are not restricted to, acts of God or of the public enemy, acts of the Government in either its sovereign or contractual capacity, fires, floods, epidemics, quarantine restrictions, strikes, freight embargoes, and unusually severe weather; but in every case the failure to perform must be beyond the control and without the fault or negligence of the Contractor. * * *

* * * * *

"(e) If, after notice of termination of this contract under the provisions of this clause, it is determined for any reason that the Contractor was not in default under the provisions of this clause, or that the default was excusable under the provisions of this clause, the rights and obligations of the parties shall, if the contract contains a clause providing for termination for convenience of the Government, be the same as if the notice of termination had been issued pursuant to such clause. If, after notice of termination of this contract under the provisions of this clause, it is determined for any reason that the Contractor was not in default under the provisions of this clause, and if this contract does not contain a clause providing for termination for convenience of the Government, the contract shall be equitably adjusted to compensate for such termination and the contract modified accordingly; failure to agree to any such adjustment shall be a dispute concerning a question of fact within the meaning of the clause of this contract entitled 'Disputes'."

Chief among the contentions that are made in this regard is the argument that where a solicitation enumerates, as the one here involved did, the names of Government-approved manufacturing sources, then such enumeration is, in effect, a representation by the Government that the named sources are ready, willing and able to do the work contemplated by the contract and to accomplish the same within the required time frame. Thus, the argument continues, when such representations prove to be wrong, as was said to have been the case here and the Government, at the same time, fails to allow the contractor sufficient time to qualify a new source of supply, then, under these circumstances, it is the Government that stands in breach of the contract and the contractor is exonerated from any responsibilities flowing from his failure to deliver.

The argument that is made has validity—but only to a limited extent and that to a degree insufficient to carry the day for plaintiff. Where the Government issues a contract drawing upon which are listed the names of Government-approved sources of supply, one could readily accept the proposition that such a listing constitutes a representation, *i.e.*, a warranty by the Government, that the listed suppliers have the *ability* to do the work contemplated by the contract. Indeed, the common sense of the situation could tolerate no less a construction of such contract statements. But it is quite another matter to say, as plaintiff also does, that in addition to guaranteeing the abilities of the listed manufacturers to perform, the Government is also warranting their willingness to do so and within the time period contemplated by the contract.

In *Paccon, Inc.* v. *United States*, 185 Ct. Cl. 24, 33, 399 F. 2d 162, 168 (1968), the court expressed the general rule that a warranty which would place upon the shoulders of the United States the burden of guaranteeing the performance of third parties without regard to any fault of its own is an unusual assumption of responsibility and one that "should not be inferred from ambiguous, inconclusive, or general discussions." The admonition declared in *Paccon* fits this situation even more convincingly. The contract language used here (previously quoted herein at p. 848) simply does not lend itself to the interpretation that plaintiff urges nor are there any attendant circumstances detailed in the proof from which the equivalent implication might justifiably be drawn. Fairly construed, the language that was used in the contract drawing promises only that those named can do the job; not that they will. Moreover, it would be highly unusual, to say the least, to conclude that the United States, having once approved a given supplier's technical qualifications, should thereafter be considered as having placed itself in the position of guaranteeing that supplier's willingness to undertake the work whenever a demand for the service might materialize. The realities of business life absolutely negate any such assumptions. In short, it would be nothing less than arbitrary to endorse the interpretation plaintiff espouses. On this record, no breach of contract may be imputed to the United States simply because the manufacturers that it had listed as approved sources of supply declined to undertake the work for which they had been found qualified.

Given the conclusion stated it must follow that the obligation to locate a supplier remains where that sort of obligation has traditionally rested—upon the contractor. Of course, in the circumstances detailed here, where the Government has specified that the metal-to-rubber bonding work may only be done by an approved source and where all the approved sources are found to be unavailable, the contractor would be entitled to time extensions sufficient to permit the locating of a new supplier and the securing of the Government's necessary approval. And it is precisely this point—the matter of sufficient time—which is the focus of the second part of plaintiff's chief argument.

The contention is made that since Government approval of the bonding manufacturer was not only a contract requirement but also an unavoidable prerequisite in this case (because of the unavailability of all previously approved manufacturers), then the termination of the contract before the contractor was in a position to submit work for approval was plainly a breach of contract.

This contention cannot be accepted. The argument completely overlooks the fact that the contract termination, though indeed effected before approval had been accomplished, occurred after plaintiff had failed to meet the delivery date that had been promised. To ignore this critical fact is, in essence, to say that the Government's contract reservation of a right of approval carries with it the correlative duty to hold open a contract without regard to all intervening delays until such time as the contractor is in a position to tender a product for approval. Clearly, there is no such obligation. On the contrary, contractor-caused delays in timely submitting a product for approval expose the situation to the same risks of termination as would attend the failure to make timely deliveries once approval had been given. In either case, the sufficiency of the contractor's performance is to be measured by the dates specified in the contract; where delinquencies occur which are not excusable, then termination for default is within the Government's rights.

To be sure, the rule would be otherwise if the delays resulted from circumstances with respect to which the Government bore the risk. Thus, for example, if it had been the case here that the Government had selected the subcontractor or had vouched for the competence of the one that was selected, then delays attributable to that subcontractor's technical problems (in doing the work) would remain within the Government's sphere of responsibility. However, neither of these conditions were met here. The subcontractor whose delays ultimately brought about plaintiff's default was chosen by plaintiff alone. In short, in this situation the attendant risks remain with the plaintiff.

According to the contract's terms, if the subcontractor is the source of delay, then the prime contractor may be excused only if the reasons for the delay are beyond the control and without the fault or negligence of either the contractor or its subcontractor. Manifestly, that was not shown to be the case here. The record is virtually barren of any pertinent information on this score. Nothing more appears save the fact that the subcontractor had experienced some technical problems in doing the work. There is no account either of the nature of these problems nor the reasons for them. Such being the state of the proof and given the rejection here of plaintiff's "warranty" argument, it must follow that termination before approval had been given was not erroneous.

A second argument that is raised against the correctness of the default termination is the contention that the termination was improper because it occurred at a point when plaintiff had substantially performed the contract.

Substantial performance, as that term is used here, refers to the equitable doctrine that guards against forfeiture in situations where a party's contract performance departs in minor respects from that which had been promised. Building and construction contracts offer the most frequent examples of its application though clearly the doctrine has its place in contracts for supplies as well. *See, e.g., Radiation Technology, Inc.* v. *United States*, 177 Ct. Cl. 227, 366 F. 2d 1003 (1966), and *LeRoy Dyal Co.* v. *Allen*, 161 F. 2d 152 (4th Cir. 1947).

In resisting the application of the substantial performance doctrine to the facts of this case, the Government makes the argument that that doctrine can have application in a supply contract situation only if the contractor has delivered the goods on schedule. In other words, for the Government, the matter of the substantiality of a contractor's performance is limited simply to the question of the conformity of delivered supplies.

Surely this is too narrow a view to endorse, at least for a contract of the sort here involved. It has long been the rule that, save in situations where "time is of the essence," the timeliness of a contractor's performance is as much a factor to be considered in evaluating the substantiality of that performance as are all other factors which might bear upon the adequacy of completeness of that performance. 3 A. CORBIN, CONTRACTS § 713 (1960). In an early case, *Beck & Pauli Lithographing Co.* v. *Colorado Milling & Elevator Co.*, 52 F. 700, 703 (8th Cir. 1892), it was said that "in contracts for work or skill, and the materials upon which it is to be bestowed, a statement fixing the time of performance of the contract is not ordinarily of its essence, and a failure to perform within the time stipulated, followed by substantial performance after a short delay, will not justify the aggrieved party in repudiating the entire contract * * *." Essentially the same view applies today. *See* RESTATEMENT (SECOND) OF LAW, CONTRACTS 2d § 255, Comment *c* at 598–99 (Tent. Drafts Nos. 1–7, 1973).

But notwithstanding the application of a different or more liberal rule than that being urged by the Government, the conclusion must nevertheless be reached that the substantial performance doctrine is inapplicable here. It is enough to defeat plaintiff's position to point out that, as of March 2, 1970 (the date the contracting officer wrote to inquire concerning the state of performance), the contractor's then estimated time to completion involved a requirement for approximately 30 additional days. Whether this additional required time be viewed in the context of the delivery period which the Government had initially contemplated, namely 90 days, or whether it be measured against the sum of the extensions that it had thrice granted the contractor, amounting in all to about 160 days, in neither context would a further delay of 30 days be excusable in the sense that the contractor had substantially complied with the delivery schedule. Moreover, to the additional time which the contractor had projected, there would have to be added also whatever additional testing time the Government might require in order to assure itself that the product, as offered, met the contract requirements. Thus, in net result, the delays would extend even beyond the contractor's own time estimate.

Admittedly, the purpose of the substantial performance doctrine is to avoid the harshness of a forfeiture. By the same token, however, the doctrine should not be carried to the point where the non-defaulting party is compelled to accept a measure of performance fundamentally less than had been bargained for. Substantial performance "is never properly invoked unless the promisee has obtained to all intents and purposes all benefits which he reasonably anticipated receiving under the contract." *In Re Kinney Aluminum Co.*, 78 F. Supp. 565, 568 (S.D. Cal. 1948). Given this stated restriction, it would have to be concluded that the extent of the further delay that was anticipated by the contractor goes beyond what the Government could justifiably be required to accept in the name of substantial performance.

The foregoing is not meant to suggest that every delay that might be judged to be extensive when viewed against the time requirements of the contract as a whole is, by itself, sufficient to preclude a finding of substantial performance. To the contrary, there might well be situations where performance has been brought to a point sufficient to permit the Government the satisfactory use of the product and thereafter a delay occurs with respect to a remaining minor item of work that has the effect of making 100 percent completion impossible for a period of time. Under these circumstances a delay even longer than that experienced here would not preclude a finding that substantial performance had taken place. So long as the product in its then existing condition could be put to satisfactory use by the Government, then substantial performance has been achieved. However, there is nothing in this record that would permit the conclusion that such was the state of affairs here when the contract was terminated. No more may be inferred in this situation save that performance involving substantial value had taken place. But that is not substantial performance.

There is a third argument made which is to the effect that it was error for the Board to have accepted the validity of the contract's delivery schedule because, according to plaintiff, that schedule reflected contractor-requested time extensions that had been induced by Government coercion, by threats to terminate the contract and by false representation.

There is absolutely no support for these contentions. All that the record reveals is that, with respect to the first two extensions that were sought, plaintiff relied upon the DCASR representative's advice to cite "machining difficulties" as the reason for needing more time. As to this reason, certainly a more accurate description of plaintiff's then-current problems might have been given. However, it is by no means made clear how the use of this suggested reason, in lieu of some other, operated to plaintiff's detriment in any way. The fact of the matter is that the initial two extensions that were requested by plaintiff were granted, that a later extension specifically requested because of bonding problems was likewise granted and that, with respect to all three time extensions, the amount of time that was asked for in each reflected plaintiff's own expected delivery estimations. There is not the remotest proof in this record of any Government coercion or misdealing with plaintiff sufficient to invalidate the enforceability of the contract's delivery schedule.

A final argument that is raised makes the point that, in sustaining the default termination, the Board entirely overlooked the Government's legal obligations to assist contractors participating in small business set-aside procurements. No citations of authority are offered in support of this point, though clearly the court's rules demand this. See Rule 163 (b)(3)(ii).

It is the function of the attorney and not that of the court to point out errors with specificity; this rule is the same whether the error claimed is one of fact, *see Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 661, 428 F. 2d 1241, 1248 (1970), or of law, *see Ala Moana Boat Owners' Ass'n* v. *State*, 434 P. 2d 516, 518 (Hawaii 1967). Since the proposition claimed by plaintiff is not one so generally understood as to require no supporting citation, no more need be said on the point raised save that plaintiff has not sustained its burden of showing that the Board was wrong in doing what it did.

With respect to the factual side of the case, there are a number of findings that are challenged for a claimed lack of substantial evidence. However, there is no need to take up these challenged findings individually for even if plaintiff were found to be right in some or all particulars the outcome would yet remain the same. On the few critical points in this case, the evidence is not equivocal or subject to debate: there was no warranty by the Government with respect to the availability of the suppliers that it had listed on the contract drawing; the default that occurred here was caused by a subcontractor selected by plaintiff and that default was ascertained by an assessment of performance that had been measured against a delivery schedule that had been established by plaintiff. Since none of the facts which plaintiff challenges would alter these basic points in any way, all further consideration of the challenged facts is irrelevant.

It follows from the foregoing discussions that the Board's decision must be recognized to be the final decision in the matter.

B. *The Government's Counterclaims:* In this case the Government has filed a number of counterclaims (14 in all) which collectively represent a demand for judgment in the amount of $58,992.94. The counterclaims reflect the excess reprocurement costs that were incurred by the United States in consequence of its having to purchase, on the open market, supplies that plaintiff had contracted for but failed to deliver. The counterclaims assert that, in each instance, the failure to deliver was followed by a default termination and a final decision of the contracting officer which was not thereafter appealed by plaintiff to the Armed Services Board of Contract Appeals. Further, it is stated that timely demand for payment was made upon plaintiff by the procuring agency (the Department of the Navy) and also by the General Accounting Office and that no response was given by plaintiff to either of these demands. Copies of the final decisions that were written by the contracting officers involved in these 14 procurements, together with the tabulation of excess costs that accompanied the transmittal of each of these final decisions to plaintiff are set out as Defendant's Exhibits 1–14 in the Appendix to Defendant's Cross-Motion for Summary Judgment.

To the above-described demand for judgment, plaintiff has answered as follows: first, it denies the allegations of the counterclaims "except to the extent that they are supported by the administrative record;" second, it asserts that there has been and is now in effect a bona fide assignment made under the Federal Assignment of Claims Act[9] pursuant to which any proceeds generated under the contract in issue (*i.e.*, the contract upon which the instant Wunderlich Act Review was sought) are to be paid over to the designated assignee, in this case, the First National Bank of West Chester, Pennsylvania. The existence of this assignment, says the plaintiff, bars the United States from interposing any counterclaim or set-off in this case.

The arguments which plaintiff offers are not sufficient to defeat the counterclaim demands of the Government. As to the first defense asserted, it is of no consequence that the counterclaims relate to transactions that were not part of the administrative record that had been made before the Board in this case. Under 28 U.S.C. § 1503 (1970), the Court of Claims has jurisdiction "to render judgment upon any set-off or demand by the United States against any plaintiff in such court" and pursuant to Rule 40(b) of the court's rules, the United States "may state as a counterclaim [in its answer] any claim against a plaintiff not arising out of the transaction or occurrence that is the subject matter of the petition." In this instance the counterclaim demands of the United States relate to transactions totally independent of the subject matter of the disputes proceeding that plaintiff commenced before the Armed Services Board of Contract Appeals; those demands are properly raised here for the first time.

With respect to the second defense raised, this too falls wide of the mark. Assuming the existence of the assignment claimed by plaintiff, then any recovery of the contract proceeds covered by that assignment would, of course, be afforded statutory protection against reduction or set-off on account of transactions arising independent therefrom. 31 U.S.C. § 203, 41 U.S.C. § 15. However, this protection against a diminution in contract proceeds is a limited benefit and one that runs exclusively to the assignee. By no means could it be extended to bar the United States from obtaining a judgment, in an amount *independent* of what might otherwise be found owing the assignee, that runs exclusively against the plaintiff and that is based upon transactions unrelated to the cause of action sued on. In other words, while contract sums earmarked for an assignee are not subject to set-off or reduction on account of unrelated transactions, nevertheless, a plaintiff who sues to recover such sums in behalf of the assignee is properly subject to counterclaim demands that arise from unrelated transactions. *See Scott* v. *United States*, 173 Ct. Cl. 650, 354 F. 2d 292 (1965).

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[9] The Assignment of Claims Act of 1940, 31 U.S.C. § 203, 41 U.S.C. § 15 (1970).

Save for the two points above discussed, nothing else is said by plaintiff by way of challenging the Government's counterclaims. Thus, on the record as it now stands, the Government is entitled to the relief that it seeks. The facts it has alleged are fully supported by the documentation that was provided, namely, copies of each of the contracting officer's final decisions with each showing a transmittal to plaintiff by way of certified mail, return receipt requested; this same documentation also contains the computation showing the manner in which the excess procurement costs were calculated and the amounts thereof. In short, the proof, though limited, is sufficient to sustain the entry of judgment against plaintiff on the Government's counterclaims in the amount of $58,992.94.

## CONCLUSION

For the reasons given herein (i) plaintiff's motion for summary judgment is denied and its petition is dismissed; (ii) the Government's cross-motion for summary judgment is granted; and (iii) judgment is entered for the Government on its counterclaims in the amount of $58,992.94.

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524 F. 2d 707

# NORTHERN HELEX COMPANY v. THE UNITED STATES

[No. 454-70. Decided October 22, 1975. Plaintiff's motion for rehearing and oral argument before full court denied January 9, 1976.]

## ON THE PROOFS

**Contracts; breach; performance after breach; damages; mitigation of damages; helium purchase.**—In August 1961 plaintiff entered into a fixed-price, 22-year contract for sale of helium to the Government, a by-product of natural gas production and normally wasted into the atmosphere. Pursuant to the contract, plaintiff constructed facilities, extracted and delivered helium from December 7, 1962 onward. Plaintiff declared the contract at an end and filed suit December 24, 1970 seeking damages for defendant's breach for nonpayment, asserting that although its contractual obligation to perform had been discharged by the breach, it would continue (and has continued) to tender helium to the Government in mitigation of damages and in the interest of conservation of helium. This was done, says plaintiff, because the helium extraction facilities were integrated with its liquefied gas and petrochemical operations involving its related companies in such a way that the helium facilities must be continued whether helium is wasted or stored, and that there was a need to save helium. Although plaintiff had terminated the contract in December 1970, the Under Secretary of the Interior wrote plaintiff in January 1971 terminating the contract as of March 28, 1971. The payments made by defendant from December 24, 1970 through March 28, 1971 are considered by plaintiff a reduction of damages without prejudice to its rights. A "no prejudice agreement" was entered into under which Interior agreed to store helium which plaintiff continued to deliver through September 28, 1972 and for which storage plaintiff has paid the Government $502,545. In an opinion reported at 197 Ct. Cl. 115, 435 F. 2d 546 (1972), the court held that the failure of defendant to pay for helium delivered to it by plaintiff as required by the contract was a material breach that justified plaintiff in terminating the contract and for which plaintiff had a claim for damages; the court also held that plaintiff had not waived the breach by its continued production and tender of helium both before and after suit was filed. The court did not pass upon plaintiff's claim for damages nor upon certain other issues, and remanded the case to the trial judge to determine the amount of recovery, if any. Trial was held and the trial judge issued a recommended opinion, both parties excepting thereto. The parties stipulated the amount of helium which would have been delivered had the contract remained in force for the entire period and also stipulated plaintiff's projected performance costs for that period. Plaintiff contends that it is entitled to recover as common law damages the full contract price, adjusted upward according to the wholesale price index, without any reduction for its costs of performing the contract, and that the necessity for it to continue to the end of the contract term its helium operations because of its integrated operations was reasonably foreseeable. It is *held* (1) that since the only contract defendant had with plaintiff was a fixed-fee one for the purchase of helium, no other product being mentioned in the contract, defendant had no interest in nor obligation with respect to plaintiff's costs in performing the contract either before or after termination; the performance costs were the sole responsibility of plaintiff as the seller of helium and defendant as buyer had no liability with respect to them; (2) that Article

XXXI of the contract completely exculpates and exonerates defendant from the *cost* of operation of any facilities for extracting products other than helium from the natural gas processed through plaintiff's helium plant, and accordingly no liability can be imposed on defendant for the cost of operation of any part of the facilities constructed by the integrated companies to which defendant owes no contractual obligation; (3) that plaintiff is not entitled to recover its cost of performance of the contract to the end of the contract period and that its claim for the full contract price, escalated, without any reduction for costs of performance, is denied; (4) that since plaintiff terminated the contract on December 24, 1970 the attempted termination by defendant on March 28, 1971 was ineffective; (5) that with respect to the delivery of helium after December 24, 1970 through March 28, 1971, this was a transaction separate from the main contract which had been terminated, and represented an offer by plaintiff to sell a quantity of helium to defendant and defendant's acceptance of the offer; (6) that plaintiff is not entitled to recover the storage charges as part of its damages; (7) that plaintiff's claim of continued operation of its plant since December 24, 1970 in order to mitigate defendant's damages lacks substance; the only reason plaintiff continues to extract helium from the gas is to supply helium-free gas and nitrogen to its related companies as part of its integrated operations; (8) that the Government cannot be excused for its breach of the contract, for which plaintiff is entitled to recover common law damages, but the costs of operation of its plant to the end of the contract term in connection with its non-federal work with its related companies are too remote, speculative and consequential to be compensable as damages; (9) plaintiff is entitled to recover its pecuniary loss of anticipated and unearned profits determined and calculated as set forth in the opinion; and (10) that plaintiff is not entitled to interest on the award. Judgment is entered for plaintiff for its anticipated profits as damages for defendant's breach, and the case is remanded to the trial judge to determine such damages and for other appropriate proceedings.

**Contracts; damages; breach of contract; saving of expenses to plaintiff.**

[1] The rule of this court in awarding common law damages for breach of contract is that plaintiff is to be placed in as good a position pecuniarily as it would have been if the contract had been completely performed, at the least cost to the Government and without charging it with harms that it had no sufficient reason to foresee when the contract was made. If the Government's breach saves expense to plaintiff by discharging his duty of rendering performance in return or by excusing him from performance of a condition precedent, the amount of this saving is deducted from the damages that would otherwise by recoverable.

**United States ⚿ 74(13)**

Syllabus

**Contracts; damages; breach of contract; measure of damages; foreseeability.**

[2] The measure of damages for breach of contract depends on what liability defendant fairly may be supposed to have assumed consciously, or to have warranted plaintiff reasonably to suppose that it assumed when the contract was made. A person can only be held to be responsible for such consequences as may be reasonably supposed to be in the contemplation of the parties at the time of making the contract. Under the facts of this case, the Government could not possibly have foreseen by reason of the pre-contract, discussions and negotiations concerning the contract for sale of helium to it, the harm that would result to plaintiff's parent and sister companies in their subsequent interrelated operations of extraction of nitrogen, propane, ethane and heavier liquids from the natural gas from which the helium was extracted.

United States 🔑 74(13)

**Contracts; formation of contract; negotiations prior to contract; merger in subsequent contract.**

[3] Where a final contract document has been executed, all pre-contract discussions and negotiations between the parties are merged therein. Thus, where the record does not indicate that the parties contemplated at the time of contract execution that the Government assumed any liability or responsibility for the alleged integrated operations of plaintiff's related companies and where the contract, which provides that its terms express and constitute the full agreement between the parties, does not impose any obligation on the Government to pay plaintiff's costs of performing the subject contract for sale of helium to the end of the term, nor any obligation to pay any costs with reference to plaintiff's said integrated operations, the Government is absolved from liability for any costs of such integrated operations.

United States 🔑 70(18)

**Contracts; performance; performance after breach.**

[4] Where plaintiff on December 24, 1970 terminated its contract for sale of helium because of the Government's breach by nonpayment, but continued to tender the product for the alleged purpose of mitigating damages, and where the Government considering the contract still in effect until it was "terminated" by the Under Secretary of Interior on March 28, 1971 continued to accept and pay for the tendered helium up to the latter date but refused to accept it thereafter, since the "termination" in March 1971 was ineffective because the contract had already been terminated by plaintiff, payment by defendant after plaintiff's termination was not a payment under the contract. Consequently, after plaintiff's termination, the transaction constituted plaintiff's offer to sell a quantity of helium to defendant at a price and defendant's acceptance of the offer,

closing the transaction. This transaction was separate and apart from the contract in controversy.

United States ⚿ 72(9)

**Contracts; damages; storage costs.**

[5] Under the circumstances of this case, where, after plaintiff terminated the contract for defendant's breach, the parties entered into an arm's-length agreement whereby the Government agreed to store helium for plaintiff's account delivered after March 28, 1971 for which storage plaintiff has paid, title to the helium remaining in plaintiff and redelivery to be made to plaintiff on demand, plaintiff is not entitled to recover the storage charges as a part of its damages for the breach since the agreement was made after termination of the contract and, both parties having complied with the terms of the agreement, an accord and satisfaction was reached between the parties.

United States ⚿ 74(6)

**Contracts; damages; mitigation of damages; reasonable commercial judgment.**

[6] The guiding principle where a seller continues to manufacture and deliver after breach of contract, is whether, in the individual circumstances, the seller exercised reasonable commercial judgment in so doing in an effort to mitigate damages, although the obligation to perform has been discharged by the buyer's total breach. The matter of reasonable judgment is to a large degree controlled by the concept of good faith. Where plaintiff continued to operate its facility for producing helium (which admittedly has no market value) after defendant's breach solely in order to furnish without charge helium and nitrogen-free gas to its parent company and nitrogen to its sister company with whom defendant was not in privity, and not in order to mitigate defendant's damages, plaintiff's continued and continuing performance following breach was not an exercise of reasonable commercial judgment within the contemplation of the rule.

United States ⚿ 74(12)

**Contracts; damages; proof of damages.**

[7] Where plaintiff, after contract termination for defendant's breach, as a mitigating circumstance sold helium to a third party, the mere listing of claimed transportation expenses of the helium and travel expenses incurred by plaintiff in trying to sell helium, are not acceptable as proof of the expenses' correctness, reasonableness or necessity. Proper proof of these items of expense are required before the court will offset them against the sum which the Government is entitled to have credited to any damages that may be awarded to plaintiff.

United States ⚿ 74(10)

**Contracts; damages; consequential damages.**

[8] Plaintiff, as a seller of helium, is not entitled to consequential damages. ANDERSON, UNIFORM COMMERCIAL CODE, § 2-708:15.

United States ⚿ 74(12)

**Contracts; damages; consequential damages.**

**[9] Consequential damages are not recoverable in a common-law suit for breach of contract, especially in suits against the United States such as the instant case where plaintiff claims common law damages for the costs of operation of its plant to the end of the contract term in connection with its non-federal work with its related companies, because such costs are too remote, speculative and consequential to be compensable as damages.**

**United States 🔑 74(12)**

**Contracts; damages; measure of damages; anticipated profits; when recoverable.**

**[10] In the present action against defendant for common law breach of contract, plaintiff is entitled to recover its pecuniary loss of anticipated and unearned profits.**

**United States 🔑 74(15)**

**Contracts; damages; measure of damages; price escalation clause; wholesale price index.**

**[11] Article 7.3 of the contract providing for escalation of anticipated revenues from the contract in accordance with the article's wholesale price index formula is applicable only in event plaintiff were awarded the full contract price as common law damages for defendant's breach; since anticipated profits only are awarded the article should not be applied after the breach date because thereafter the contract was terminated and of no further force and effect.**

**United States 🔑 74(15)**

**Interest; claims against the United States; when allowable.**

**[12] In non-condemnation cases interest cannot be awarded against the Government in the absence of a statute, treaty or contract providing for interest, whether it is called interest, penalty, offset or damages.**

**United States 🔑 110**

*Clarence T. Kipps, Jr.*, attorney of record for plaintiff. *F. V. Roach*, *Ralph P. Blodgett*, *Jim W. Krueger*, *Dean W. Wallace*, *Edward J. Vandermark*, *John Lloyd Rice* and *Miller & Chevalier*, of counsel.

*Edward J. Friedlander* with whom was *Assistant Attorney General Rex E. Lee*, for defendant, *James F. Merow*, of counsel.

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Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, SKELTON, NICHOLS, and KUNZIG, *Judges*.

SKELTON, *Judge*, delivered the opinion of the court:

In this case Northern Helex Company (plaintiff or Northern Helex) seeks in its second amended petition to recover

$99,964,000 from the Government as damages for a breach of contract to purchase helium. The plaintiff is a wholly owned subsidiary of Northern Natural Gas Company (Northern). The liability issue in the case was decided in favor of the plaintiff by this court in *Northern Helex Co.* v. *United States*, 197 Ct. Cl. 118, 455 F. 2d 546 (1972). In that decision we held that the failure of the Government to pay for helium delivered to it by the plaintiff as required by the contract was a material breach that justified the plaintiff in terminating the contract and for which the plaintiff has a claim for damages. We held further that the plaintiff had not waived the breach of the Government by its continued production and tender of helium to the Government both before and after suit was filed. However, we did not pass upon plaintiff's claim for damages nor upon other issues in the case that will be discussed below. We granted plaintiff's motion for summary judgment on liability and remanded the case to the trial judge to determine the amount of recovery, if any. A trial was held on this issue, which resulted in findings of fact and a recommended decision by the trial judge in favor of the plaintiff for the recovery of $78,012,142 as damages from the Government.[1] Both the plaintiff and the defendant excepted to the trial judge's report. The facts necessary for our decision are included in this opinion. Our task is to decide the issues left undecided in our prior opinion cited above. Most of the basic facts are set forth in that opinion, and, for the sake of clarity and continuity, are repeated below with certain omissions and additions.

The plaintiff, a wholly owned subsidiary of Northern Natural Gas Company, made a contract with the United States, acting through the Department of Interior, on August 15, 1961. This agreement was authorized by the Helium Act Amendments of 1960 (50 U.S.C. § 167, et seq.), a long-range program designed to conserve helium as a natural resource for future use. A by-product of the production of natural gas, helium was wasted daily as it escaped into the atmosphere at such a rate that the helium-bearing gas resources in the southwestern states were expected to be inadequate for national needs by 1980–1985. Because of the unique properties of helium and the slim likelihood of finding new sources as rich as the Hugoton Area, involved here, the helium conservation program was initiated. One of its components was plaintiff's contract.

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[1] The findings of fact and recommended decision of Trial Judge Louis Spector have been helpful, but we reach a somewhat different result.

This provided for the purchase by the United States of the helium to be produced by Northern Helex which was estimated to be 13.5 billion cubic feet over a span of years. The helium was to be extracted from Hugoton gas, delivered, and paid for each month over the 22-year contract period with an annual fiscal year limitation of $9.5 million. The unit price of $11.24 per thousand cubic feet had increased to $12.41 by the date this action was filed (in December 1970) due to automatic price adjustments envisaged by the agreement. The Government also entered into similar contracts with Cities Service Helex, National Helium Corporation, and Phillips Petroleum Company. Pursuant to its contract, Northern Helex constructed facilities, extracted, and delivered helium from December 7, 1962, onward.

The helium conservation program was intended to be self-liquidating, financed with borrowing authority provided by Congress and with funds lent by the Treasury Department to Interior. The borrowed funds were to be supplemented and, within 25 to 35 years, repaid with interest from helium sales proceeds. Interior was to sell some of the helium at a price high enough to pay for the entire program and still have 40–50 billion cubic feet in storage for use after 1983. The "federal market"—consisting of Government agencies, their prime contractors and subcontractors—was expected to purchase its major helium requirements from Interior and provide the basic financing for the whole program.

Unfortunately this forecast did not prove itself. The difficulty was that, from the mid-1960's, private helium plants began to operate outside the program and to sell to Government contractors. Also, other conservation contractors produced helium in excess of the amount which could be sold to Interior under their contracts and sold the excess in competition with Interior at lower prices. Northern Helex sold helium only to Interior, but over the period of 1965–1969, some $25 million (it is said) was lost to the program because helium was purchased for federal use from other private producers rather than the Bureau of Mines. Congress did not appropriate enough funds to satisfy the payments due under the agreements of Northern Helex and its companions in the program. By letter dated November 26, 1968, Interior informed plaintiff that the Government would be unable to make payments when they became due as of January 1969. Beginning in December 1968, and continuing through 1969 the Government failed to pay the complete amount owed. Arrearages in the monthly payments ranged from a low of $664,122 to a high of $3,235,349. For deliveries from November 1969 through November 1970, the Government paid nothing at all.

In May 1970, the Interior Department convened a meeting of the four conservation contractors in which they were told that the unit price and the maximum annual payment would have to be negotiated downward. A letter of June 24, 1970 (acknowledged June 26), from Northern Helex notified the Government that its failure to make payments was a material breach which was not being waived, but that Northern Helex was willing to discuss modifications. A draft agreement which would have increased the obligations of plaintiff while the payments to it were decreased was circulated along the lines discussed in the negotiations. Meanwhile, in his request for supplemental appropriations for fiscal year 1971, the President asked only $56,100,000 in borrowing authority for obligations under the helium contracts. This amount was not sufficient to pay outstanding debts and all anticipated deliveries for the remainder of the fiscal year but only to cover five months of operation at the present contract price and seven months at the reduced price proposed by Interior. No real progress was made during the negotiations, as Northern Helex delivered 657,008,000 cubic feet of helium from November 1, 1969, through November 30, 1970, plus an additional 44,647,000 through December 24, 1970, the date of filing of the petition in this court, without receiving any payment.

In its petition, plaintiff alleged that although its contractual obligation to perform had been discharged by the Government's material breaches of contract, it would continue to tender helium to the Government in mitigation of damages and in the interest of conservation. This was done, according to Northern Helex, because helium extraction facilities have been interrelated with its liquefied petroleum gas and petrochemical operations in such a way that the helium facilities must be continued in operation whether helium is wasted or stored. Northern Helex has no facilities for storage, purification, distribution, or marketing of helium and there is so little demand for the gas in the private market that the company has not considered it financially feasible to develop such facilities. On December 30, 1970, Northern Helex notified Interior of this suit and of its decision to continue to deliver helium, despite the material breach, because of the integration of its facilities and the need to save helium.

On January 14, 1971, the United States sent Northern Helex a check for $8,671,631.99—the total amount then due for all helium delivered by plaintiff—which the company cashed, without any notation on the check, and it then amended its petition to reflect payment as a reduction of damages. On January 26, 1971, the Under Secretary of Interior wrote plaintiff terminating the contract under its termination clause, effective March 28, 1971. Plaintiff does not acknowledge the legitimacy of this asserted termination. Since then, a "no prejudice agreement" has been entered into under which Interior agrees to store helium which Northern Helex has continued to deliver. Payment also continued. Northern Helex billed Interior for helium delivered through March 31, 1971. The bills carry a legend indicating that delivery, submission of documents, and payment shall be without prejudice to the rights of the parties. After the recent Congressional appropriation of funds, on June 23, 1971, Northern Helex received a check of $2,285,872.87 for the period of December 1970 through March 28, 1971. This June payment is also considered by Northern Helex to be a reduction of damages without prejudice to its rights.

The parties stipulated that had the contract remained in effect from December 24, 1970, through August 15, 1983, the plaintiff would have delivered 6,467,000,000 cubic feet of helium to the Government. The trial judge found that at the contract price of $12.41 per m.c.f. in effect when the contract was terminated on December 24, 1970, the Government would have paid the plaintiff the sum of $80,255,000 for such helium.

The parties stipulated further that had the contract remained in effect to the end of the contract period, plaintiff's costs in performing the contract would have amounted to the sum of $43,067,413.[2]

The plaintiff contends that it is entitled to recover as common law damages for the breach the full contract price of $80,255,000, adjusted upward according to the wholesale price index, without any reduction for its costs of operation ($43,093,793) in performing the contract. The basis for this contention is that plaintiff's helium extraction plant is a part of an integrated operation involving itself, which owns and operates the helium extraction plant, and the following additional companies and their operations: Northern Natural Gas Company (Northern), which owns the natural gas and also owns and operates a natural gas pipeline and transmission system; Northern Gas Products Company (Gas Products), which owns and operates ethane and liquefied gas products facilities; and Northern Petrochemical Company (Petrochemical), which owns and operates petrochemical facilities. Northern is the parent company and all of the other companies are its wholly owned subsidiaries. The integration relied on by the plaintiff consists of the following operations. Northern supplies the natural gas from its pipelines to the plant of Gas Products in Bushton, Kansas, which extracts propane, ethane, and heavier liquids from the gas. The helium plant of plaintiff at Bushton extracts helium and nitrogen from the gas and returns the gas to Northern for sale to fuel customers, while a low B.T.U. nitrogen-methane mixture is piped to Gas Products for burning the methane as fuel, and for rejection of the nitrogen by venting it into the air. Petrochemical's plant is located in Joliet, Illinois, but is connected with the Bushton, Kansas complex by a pipeline from which it receives Bushton feedstocks and especially the high purity ethane for which it was designed and on which it depends. The Petrochemical complex consists of an ethylene oxide—ethylene glycol plant, an olefins plant, and a low density polyethylene plant. The plaintiff alleges that Northern, through its wholly owned subsidiaries mentioned above, has an investment of 300 million dollars in all of these plants. These companies allegedly have interlocking agreements or understandings providing for the furnishing of services and products to each other. The plaintiff says that it cannot stop operating its helium plant because it is obligated by contract with Northern to process up to 500,000,000 cubic feet of Northern's gas per day for the extraction of helium-gas mixture for 22 years (to 1983), and because it is necessary for plaintiff's helium plant to extract a nitrogen-methane mixture from the gas so that Gas Products can reject the nitrogen and burn the methane as fuel. The contract between the plaintiff and Northern is in evidence and only requires the plaintiff to extract helium. Nitrogen extraction is not mentioned. There is no showing how or why the plaintiff is obligated to extract nitrogen for the benefit of Gas Products and Petrochemical and their operations.

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[2] Excludes consideration of potential liability for Landowners/Producers claims; excludes any adjustment for inflation (stated in 1971 dollars); and excludes interest for money borrowed or to be borrowed by plaintiff.

The plaintiff contends that the pre-contract discussions by the parties about integration of helium, nitrogen removal, liquid propane gas (LPG), and petrochemical facilities show that the necessity for Northern Helex to continue operation of the helium facilities to the end of the contract period in the event of a breach (or termination) by the Government was not only reasonably foreseeable by the Government, but was expressly recognized before and during the negotiation of the contract, as well as in the terms of the contract. By reason of these facts, plaintiff claims that it is entitled to recover its cost of operation to August 15, 1983, along with its profit, which together equal the full contract price. We do not agree. Neither the facts in this case nor the law applicable thereto obligates or requires the Government to pay the costs of plaintiff's performance from the date of the breach to the end of the contract term. There was no privity of contract between the Government and Northern, or Gas Products, or Petrochemical. The Government had nothing whatsoever to do with the operations of those companies nor with their obligations with or to each other. There was no obligation on the part of the Government to remove helium and nitrogen from the gas so that Northern could have gas of pure quality to sell to fuel customers. Neither was the Government obligated to remove nitrogen from the gas so that Gas Products could reject it, nor was the Government concerned or involved in any way with the extraction of propane, ethane, LPG and other hydrocarbons from the gas by Gas Products. There was no obligation on the part of the Government to see that high purity ethane was furnished by Gas Products to Petrochemical in Joliet, Illinois. The plaintiff has shown no connection whatever between the Government and these companies and their operations.

The only contract that the Government had was with Northern Helex for the purchase of helium. No other product is mentioned in the contract. This was a fixed fee contract. The Government had no interest in nor obligation with respect to plaintiff's costs in performing the contract either before or after termination. Performance costs were the sole responsibility of the plaintiff as the seller of the helium and the Government as the buyer had no liability with respect to them.

The Government is even further removed from liability for the so-called "integrated costs" of plaintiff resulting from the integrated operations of plaintiff with Northern, Gas Products and Petrochemical, because the contract between plaintiff and the Government provided:

> ARTICLE XXXI. GENERAL
>
> * * * * *
>
> 31.3 In connection with Seller's plant, Seller at its sole risk, cost and option may construct and operate, or cause to be constructed and operated, facilities for extracting products other than helium from the natural gas processed through said helium plant.

This clause completely exculpates and exonerates the Government from the *cost* of operation of any "facilities for extracting products other than helium from the natural gas processed through said helium plant" constructed and operated by plaintiff. The only facility constructed and operated for such purpose by plaintiff was that part of its helium extraction plant that extracted nitrogen which it furnished to Gas Products. The above clause relieves the Government of any liability for the cost of extracting nitrogen from the gas by plaintiff. None of the remaining integrated facilities for the extraction of ethane, propane, LPG, petrochemicals, etc., from the gas were constructed or operated by the plaintiff but by Northern, Gas Products, and Petrochemical with which the Government had no privity of contract. Since the above clause in the contract protects the Government from liability for the cost of operation of any such facility constructed and operated by the plaintiff, no liability can be imposed on the Government for the cost of operation of any part of the facilities constructed by plaintiff's parent and sister companies to which the Government owes no contractual obligation. Even if the plaintiff "caused to be constructed and operated" the plants of Northern, Gas Products, and Petrochemical, the above contract clause protects the Government from liability for their operation costs, because this contingency is covered.

The basic rule for awarding common law damages for a breach of contract is stated as follows in Restatement of Law, Contracts § 329, comment a at 504:

> In awarding compensatory damages, the effort is made to put the injured party in as good a position as that in which he would have been put by full performance of the contract, at the least cost to the defendant and without charging him with harms that he had no sufficient reason to foresee when he made the contract. * * *[3]

See also subsidiary rule section 335 [Id.]:

> If the defendant's breach of contract saves expense to the plaintiff by discharging his duty of rendering a performance in return or by excusing him from the performance of a condition precedent, the amount of this saving is deducted from the damages that would otherwise be recoverable.

See also 5 Corbin, Contracts §§ 1038, 1053, 11 Williston, Contracts, § 1353, (3d ed. 1968).

The plaintiff argues that the above rule (section 329) when properly applied to the facts of this case entitles it to recover its costs for performance of the contract to the end of the contract term. The basis for this argument, as pointed out above, is that by reason of the pre-contract discussions and negotiations between the parties, it was contemplated that the plaintiff would build and operate an integrated plant that would extract nitrogen, ethane, propane, LPG, other hydrocarbons, and petrochemicals, in addition to the helium to be sold to the Government, and that the Government agreed to and encouraged such a plan. The plaintiff contends that by reason of these facts, the Government had sufficient reasons to foresee the harm that would result to the plaintiff if the Government breached or terminated the contract, and that this imposed an obligation on the Government to pay the cost of plaintiff's performance to the end of the contract term if the Government breached the contract. We do not agree, because the facts do not support the theory of the plaintiff, as will be shown below.

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[3] The court has qualified or clarified this rule by noting that plaintiff is to be placed "in as good a position *pecuniarily* as [it] would have been if the contract had been completely performed." *J. D. Hedin Constr. Co.* v. *United States*, 197 Ct. Cl. 782, 803, 456 F. 2d 1315, 1327–28 (1972). [Emphasis supplied.] *G. L. Christian & Associates* v. *United States*, 160 Ct. Cl. 1, 312 F. 2d 418, *cert. denied*, 375 U.S. 954 (1963).

The facts show that Northern was planning as a commercial undertaking the integrated operation (that was finally constructed and operated) as early as 1957. At or about this time it had architects and engineers to draw up plans for such an enterprise. These were abandoned when it began negotiations with the Government. However, on October 28, 1960, Northern entered into a contract with Gas Products whereby the latter company would construct and operate a plant at Bushton, Kansas, to extract and remove various hydrocarbons from natural gas to be supplied by Northern. The contract period was 20 years. This contract was made almost a year before the contract was executed between the plaintiff and the Government on August 15, 1961. Consequently, the contract with Gas Products could not have been foreseen nor contemplated by the Government when its contract was executed with the plaintiff, because the Gas Products contract had been in force for almost a year. Furthermore, the Gas Products contract was amended on June 26, 1967, almost six years after the contract with plaintiff involved here was executed. Such amendment provided that at that time ethane was not being extracted from the gas by Gas Products, but that it was proposed to be so extracted by 1969 and be in full production by the end of 1974. These activities were to take place eight and 13 years after the contract between the plaintiff and the Government was executed on August 15, 1961. The Government could not have foreseen that these events would occur after so long a time. It should be kept in mind that the Gas Products plant is the central part of plaintiff's alleged integrated operations. It receives the nitrogen from plaintiff's extraction plant which it rejects. It extracts ethane, propane, LPG, and other hydrocarbons from Northern's gas. Furthermore, it supplies Petrochemical with pure ethane, from which the latter company extracts the petrochemicals mentioned above. To hold the Government responsible for costs that support such operations approaches speculation which we cannot approve. As pointed out above, we do not know how or why the plaintiff is obligated to supply nitrogen to Gas Products, nor how or why Gas Products is required to supply pure ethane to Petrochemical. The Government could not possibly have foreseen these activities nor assumed any liability with reference thereto, because, among other reasons, even now the facts regarding them are unknown to the Government. There is no evidence whatever that the parties contemplated at the time the contract was signed that the Government assumed any liability or responsibility for the alleged integrated operations, nor that the Government would be liable for the cost of plaintiff's performance in case the contract was terminated. The evidence, including the contract, point the other way and negate any such understanding or assumption. The Supreme Court said in *Globe Refining Co.* v. *Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903):

> * * * If a contract is broken the measure of damages generally is the same, whatever the cause of the breach. We have to consider therefore what the plaintiff would have been entitled to recover in that case, and *that depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed*, when the contract was made.
>
> This point of view is taken by implication in the rule that "*a person can only be held to be responsible for such consequences as may be reasonably supposed to be in the contemplation of the parties at the time of making the contract.*" * * * *The consequences must be contemplated*

> *at the time of the making of the contract.* [Emphasis supplied.]

Plaintiff's claim for its performance costs appears to be an afterthought that was developed by it after the breach by the Government.

Furthermore, during the pre-contract discussions, the Government did not request or require the plaintiff to exhibit its plans nor to reveal its costs, because the Government was not concerned with such facts. All the Government wanted to do was to buy helium at a fixed fee and the extent and cost of plaintiff's plant and its operation was its own business that did not concern the Government.

Regardless of the pre-contract discussions and negotiations between the parties, under well settled principles of contract law, for which citation is unnecessary, all such discussions and negotiations merged into the executed contract. As has been stated, the contract does not impose any obligation on the Government to pay plaintiff's costs of performing the contract to the end of the term, nor any obligation whatever to pay any costs with reference to plaintiff's integrated operations with its parent and sister companies. As stated above, the contract absolves the Government from liability for any costs of plaintiff's integrated operations. Furthermore, with reference to the alleged pre-contract discussions and negotiations, the contract provides:

> ARTICLE XXXI. GENERAL
>
> 31.2 The terms of this contract express and constitute the full agreement between the parties thereto. There are no warranties, covenants, stipulations, or conditions existing apart from the terms of this contract.

Accordingly, we hold that the plaintiff is not entitled to recover its cost of performance ($43,093,793) of the contract to the end of the contract period, and that its claim for the full contract price of $80,255,000, escalated, without any reduction for costs of performance is denied.

The defendant has alleged what it calls an affirmative defense to plaintiff's claim for damages. We declined to decide this question in our previous decision (197 Ct. Cl. 118), but must do so in this opinion. This affirmative defense consists of the following set of facts. Notwithstanding plaintiff's termination of the contract on December 24, 1970, because of defendant's breach for non-payment as required by the contract, the defendant treated the contract as still valid until January 26, 1971, when Under Secretary of the Interior Russell sent plaintiff a notice terminating the contract as of March 28, 1971, under paragraph XII of the contract. The plaintiff challenges both statements and says that neither condition existed. The plaintiff says furthermore that the decision to terminate was not that of the Under Secretary as required by the contract but that of the Office of Management and Budget; and that in any event the Under Secretary had not complied with the National Environmental Policy Act of 1970 (42 U.S.C. § 4321, *et seq.*) by filing an environmental impact statement dealing with the termination; and, finally, that the contract had already been terminated by the plaintiff on December 24, 1970, by reason of defendant's breach; and that for all these reasons the attempted termination by Under Secretary Russell was ineffective. We hold that the last stated argument of the plaintiff is the correct one and that since the contract had been terminated by the plaintiff on December 24, 1970, there was nothing for the Under Secretary to terminate when he sent his termination letter on January 26, 1971, and that his attempted termination of the contract under paragraph XII, effective March 28, 1971, was totally ineffective because he could not terminate a contract that no longer existed. We do not reach nor decide the other questions raised by the plaintiff with respect to Under Secretary Russell's attempted termination of the contract, because it is unnecessary to do so.

After plaintiff terminated the contract on December 24, 1970, it continued to extract helium and nitrogen from Northern's natural gas, delivering the thus purified gas to Northern for its fuel customers and nitrogen to Gas Products for rejection. Ethane was furnished to Petrochemical by Gas Products for the extraction and production of the described petrochemicals. The helium thus extracted after termination was tendered to the Government for the alleged purpose of mitigating damages, according to the plaintiff. Since the Government considered the contract still in effect until Under Secretary Russell terminated it as of March 28, 1971, the Government continued to accept and pay for the tendered helium up to that date but refused to accept any helium thereafter. On January 14, 1971, the Government paid plaintiff $8,671,631.99 for helium delivered through November 30, 1970. Thereafter, on June 18, 1971, it paid the plaintiff $2,285,872.87, which defendant stated was $232,557.68 less than plaintiff was due for helium delivered from December 1, 1970, through March 28, 1971. This difference was explained by the Government as being $32,557.68 due the Government under an interim contract 14-09-0060-3085 for storage of helium by the Government for the plaintiff from March 28 to April 30, 1971,[4] and $200,000 claimed by the Government in a counterclaim filed by the Government in this case for the value of certain helium delivered by the plaintiff which was processed from natural gas extracted from land owned by the Government under leases from the Government to third parties.[5] The $2,285,872.87 included $532,431 for helium delivered from December 1, 1970, through December 25, 1970, and $1,753,442, for the period from December 25, 1970, through March 28, 1971. The Government has paid $1,786,000 to plaintiff for helium delivered subsequent to the breach, which includes the $32,557.68 mentioned above. All the helium received for the account of the Government has been paid for. The plaintiff contends that this $1,786,000 represents a part of the damages due it for the breach by the Government. The Government says it represents payment for helium received under the contract. We think both theories are wrong. The argument of the plaintiff would work against its interest because if approved, it would have to give the Government credit for the $1,786,000 on any damages it is awarded in this case. Furthermore, this payment was not one for damages and cannot be so considered. The Government's position is likewise erroneous. The payment was made after the plaintiff had terminated the contract on December 24, 1970, and consequently, it was not and could not have been a payment under the contract. We conclude with respect to this transaction that after the contract was terminated on December 24, 1970, the plaintiff offered to sell a quantity of helium to the Government at a price of $12.41 per m.c.f. and the Government accepted the offer and received and paid for it and the transaction was closed. There was a complete accord and satisfaction between the parties with reference to it. This course of dealing was separate and apart from the contract and has no effect on any issue in this case. We leave the parties where we find them with respect to this sale and payment after the contract was terminated.

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[4] On or about March 26, 1971, the parties entered into an interim contract for storage of helium for plaintiff by the Government without prejudice to plaintiff's rights to damages, for which storage plaintiff agreed to pay specified fees. This storage continued until September 28, 1972. The plaintiff has paid $502,545 for this storage.

[5] This counterclaim has been deferred for later proceedings and is not a matter to be decided by us at this time.

We now consider the interim storage issue. As stated above, the plaintiff has paid the Government the sum of $502,545 for storage of helium for its account delivered after March 28, 1971. This payment was made in accordance with the agreement of the parties made on or about March 26, 1971. Both parties agree that the title to the stored helium is in the plaintiff and that the Government will deliver it to the plaintiff on demand. Here again we have a transaction entered into by the parties after the termination of the contract that has nothing to do with the contract itself nor any issues in this case. The parties executed the storage contract at arm's length and both have complied with its terms. The following letter from the plaintiff shows that it fully understood that the helium was being stored for it by the Government and that it was willing to pay, and did pay, the Government for such storage:

> Mr. Harold W. Lipper
> Chief, Division of Helium
> United States Department of the Interior
> Bureau of Mines
> Washington, D.C. 20240
>
> Dear Mr. Lipper:
>
> Enclosed is our check in the amount of $195,260.88, which represents full payment of storage charges due under the Interim Storage Contract through August of 1972.

> By reason of our inability to find a sufficient market for helium and the tremendous financial burden placed upon us by Interior's breach of the Helium Purchase Contract, we can not justify the storage of additional volumes of helium produced subsequent to September 28, either on a short-term or long-term basis. Thus, we are not in a position to renew the Interim Storage Contract.
>
> We will, however, continue to pay storage charges accruing upon our helium remaining in storage after September 28. Although we expect to pay you at the rate specified in the Interim Storage Contract, we are hopeful that more equitable storage charges might be arranged.
>
> You have acknowledged that the charges we have heretofore paid under the Interim Agreement cover the redelivery of our helium. Therefore, we call upon Interior to continue the redelivery of helium to Kansas Refined Helium as in the past.
>
> In furtherance of the conservation of helium and in mitigation of the losing party's damages, we will continue tendering helium to Interior subsequent to September 28. It is understood that Interior's acceptance thereof will in no way prejudice either party's legal position.
>
> Very truly yours,
>
> /s/ S. F. Segnar
> S. F. Segnar
> President

Notwithstanding the foregoing facts, plaintiff seeks the recovery of the $502,545 storage charges as a part of its damages. We do not agree that it is entitled to such recovery. Here again the parties entered into an interim storage contract at arm's length and both parties performed the contract according to its terms. The Government stored the helium for the plaintiff and will deliver it to the plaintiff on demand. The plaintiff has paid for the storage according to the interim contract. The transaction is complete and an accord and satisfaction has been reached between the parties. We leave them where we find them with regard to the storage issue, which has nothing to do with the main issues in the case before us. The plaintiff is not entitled to recover such storage charges.

Paragraph 7.4 of the contract in issue provided a formula to cover plaintiff's potential liability to the lessee/producers for the value of helium not sold to the defendant under either a total price or projected unearned profit theory of damages. The defendant contends that the plaintiff would no longer have any contingent liability to the lessee/producers after either December 24, 1970, the date plaintiff terminated the contract, or March 28, 1971, the date defendant ceased to receive and pay for helium. The damage issue raised is whether the contingent liability is to be regarded as a potential cost of operation of the plaintiff or a potential profit. By a stipulation following trial, the parties deferred the resolution of this issue to later proceedings. Accordingly, we do not decide it. These claims have been the subject of other litigation. *See Northern Natural Gas Co.* v. *Grounds*, 441 F. 2d 704, 723 (10th Cir. 1971), *cert. denied*, 404 U.S. 951; *Ashland Oil Inc.* v. *Phillips Petroleum Co.*, 364 F.Supp. 6 (N.D. Okla. 1973).

The plaintiff has continued to operate its plant and extract helium and nitrogen from natural gas from the date it terminated the contract on December 24, 1970, up to the present time, claiming that it has done so and continues to do so to mitigate defendant's damages. This mitigation claim lacks substance. The helium is vented into the air and wasted. The plaintiff admits that the helium has no market value. It is unreasonable in the extreme for the plaintiff to say that for over 4½ years it has continued to extract valueless helium from the gas and wasted it in the air solely for the purpose of mitigating defendant's damages. The rules applicable to the right of a seller to continue the manufacture and identification of goods to the contract are to be found in Sections 2–704(2) and 2–709(1)(b) of the Uniform Commercial Code. As stated by the court in its decision in *Northern Helex Co.* v. *United States*, 197 Ct. Cl. 118, 129, 455 F. 2d 546, 553 (1972):

> * * * The guiding principle is whether, in the individual circumstances, the seller exercised "reasonable commercial judgment" in continuing to manufacture and deliver, in the effort to mitigate damages, although

> his obligation to perform had been discharged by the buyer's total breach. * * *

Defendant contends that since plaintiff's facility was continued in operation *solely as an accommodation and without charge* to Northern, its parent corporation, and to a sibling corporation, *i.e.*, Gas Products, *to whom plaintiff owed no contract duty and the continued operation patently was not performed in an effort to mitigate damages*, plaintiff's continued and continuing performance following breach was not an exercise of "reasonable commercial judgment" within the contemplation of the rule. *Anderson*, Uniform Commercial Code, § 2-704: 5, n.10 at 535, states that "the matter of reasonable judgment is to a large degree controlled by the concept of good faith." It is obvious that after the plaintiff terminated the contract on December 24, 1970, or after the Government quit accepting and paying for helium on March 28, 1971, or after the plaintiff quit storing helium in the Government facility on September 28, 1972, the plaintiff did not extract helium to mitigate defendant's damages but did so in order to furnish helium and nitrogen free gas to Northern and nitrogen to Gas Products. The only mitigating circumstance shown by the evidence were sales by the plaintiff after the termination of the contract and during the years from 1971 through 1976 of quantities of helium to Kansas Refined Helium for the total sum of $2,872,547. The Government is entitled to have this sum credited to any damages that may be awarded to the plaintiff against the Government in this case. The plaintiff claims expenses for transportation in connection with this sale in the sum of $477,387 and travel expense in trying to sell helium during 1971 and 1972 in the sum of $13,032. The defendant contends, and we agree, that the plaintiff did not prove that these amounts were correct, reasonable, or necessary. All the proof that plaintiff offered was its Exhibits 86E and F which were mere listings of these claimed expenses. The plaintiff should have proven that these expenses were spent, that the amounts were correct, reasonable, and necessary, and such other facts regarding them as were relevant. *River Construction Corp.* v. *United States*, 159 Ct. Cl. 254, 271 (1962).

Exhibits 86E and F show that we are not being unduly technical about these items. These exhibits are as follows:

NORTHERN HELEX COMPANY

*Sales to Kansas Refined Helium*

| *Year* | *Volume (Mcf)* | *Transportation* | *Revenue* |
|---|---|---|---|
| 1971 | 2, 351 | $ 800 | $ 22, 335 |
| 1972 | 54, 964 | 46, 598 | 522, 370 |
| 1973 | 60, 000 | 105, 288 | 570, 000 |
| 1974 | 70, 000 | 122, 836 | 665, 000 |
| 1975 | 80, 000 | 140, 384 | 760, 000 |
| 1976 | 35, 036 | 61, 481 | 332, 842 |
| Totals | 302, 351 | $477, 387 | $2, 872, 547 |

WDW: 23 March 1973

NORTHERN HELEX COMPANY

*Travel Expenses Incurred Trying to Sell Helium*

| | |
|---|---|
| 1971 | $4, 778. 70 |
| 1972 | 8, 253. 45 |

Salary and telephone expenses unknown.

Exhibit 86E was prepared and filed in court in 1973, yet it shows transportation charges for the future years of 1974, 1975, and 1976. Obviously, these charges are mere estimates and have not been incurred. Exhibit 86F does not show what the travel expenses were, who incurred them nor any other relevant fact regarding them. Ordinarily, we would reject these claimed items of expense for lack of proof. However, in view of the fact that further proceedings at the trial level of this court will be required in this case, the plaintiff should be afforded an opportunity to make the proper proof of these items of expense, and if it does so, the court will consider them as valid, mitigating expense claims.

The plaintiff flatly accuses the Government of wasting helium because it will not accept plaintiff's offer to furnish the helium to the Government provided the Government pays plaintiff the full contract price for it. In this regard the plaintiff says:

> * * * If defendant continues to reject the offer and causes the helium to be wasted, that is the Government's choice as long as the taxpayers permit such irresponsible action. [Pltf's Reply Brief at 81.]

This argument is unpersuasive. It is clear that the only reason the plaintiff continues to extract helium from the gas is to supply helium-free gas and nitrogen to its related companies as a part of its integrated operations. It is obvious that the plaintiff is not extracting the helium through any patriotic motivation to preserve it as a natural resource for future generations. If that were the case, it could donate the helium to the Government since it is wasting the helium anyway. After all, it is the plaintiff, and not the Government, that is wasting the helium into the atmosphere. That can hardly be said to be an irresponsible act on the part of the Government. We are not advised whether the plaintiff is wasting the helium voluntarily or is being required or forced to do so by Northern, Gas Products, Petrochemical or anyone else. If the wasting is an irresponsible action, it is not that of the Government.

The Government cannot be excused for its breach of the contract. The plaintiff is entitled to recover common-law damages for such breach. However, it is not easy to calculate such damages in a case as complex as this one. As a seller of helium, it is not entitled to consequential damages. *Anderson*, Uniform Commercial Code, § 2–708 : 15. Furthermore, remote and consequential damages are not recoverable in a common-law suit for breach of contract. *See Globe Refining Co.* v. *Landa Cotton Oil Co.*, 190 U.S. 540, 543 (1903). This is especially true in suits against the United States for the recovery of common-law damages, such as the instant case. *See Ramsey* v. *United States*, 121 Ct. Cl. 426, 101 F. Supp. 353 (1951), *cert. denied*, 343 U.S. 977 (1952); *Dale Constr. Co.* v. *United States*, 168 Ct. Cl. 692, 738 (1964); *Specialty Assembling & Packing Co.* v. *United States*, 174 Ct. Cl. 153, 175, 355 F. 2d 554, 567–68 (1966); *William Green Constr. Co.* v. *United States*, 201 Ct. Cl. 616, 626–27, 477 F. 2d 930, 936–37 (1973), *cert. denied*, 417 U.S. 909 (1974).

In the *William Green Constr. Co.* case we said:

> * * * And even in a common-law suit there would be no recovery for general loss of business, the claimed loss of the entire Green net worth, and losses on the non-federal work—such damages are all deemed too remote and consequential. *See Ramsey* v. *United States*, 121 Ct. Cl. 426, 433–35, 101 F. Supp. 353, 357–58 (1951), *cert. denied*, 343 U.S. 977 (1952); *Dale Constr. Co.* v. *United States*, 168 Ct. Cl. 692, 738 (1964); *Specialty*

*Assembling & Packing Co.* v. *United States*, 174 Ct. Cl. 153, 175, 355 F. 2d 554, 567–68 (1966).

In *Ramsey* v. *United States*, *supra*, we held:

> Plaintiffs allege that the Government's failure to pay the money promptly was the immediate cause of the corporation's financial difficulties which resulted in a reorganization under the Bankruptcy Act. In actions for breach of contract the damages are ordinarily limited to the natural and probable consequences of the breach complained of, *and the damages remotely or consequently resulting from the breach are not allowed.* * * *
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> * * * * *
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> The profits lost from the corporation's over-all business activities, because of its shortage of capital allegedly occasioned by the Government's failure to pay the contract amounts when due, may not be recovered either. It is important to bear in mind that the corporation's claim is not for the anticipated profits of the contracts in question, but is a claim for the anticipated profits of its entire business enterprise. *The lost profits of these collateral undertakings, which the corporation was unable to carry out, are too remote to be classified as a natural result of the Government's delay in payment.* The statement of this court in *Myerle* v. *United States*, *supra*, p. 26, [33 Ct. Cl. 1 (1897)] fully disposes of this claim:
>
> * * * But we think there is a distinction by which all questions of this sort can be easily tested. If the profits are such as would have accrued and grown out of the contract itself, as the direct and immediate results of its fulfillment, then they would form a just and proper item of damages, to be recovered against the delinquent party upon a breach of the agreement. These are part and parcel of the contract itself, and must have been in the contemplation of the parties when the agreement was entered into. *But if they are such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit.* [121 Ct. Cl. at 433, 434–35, 101 F. Supp. at 357–58.] [Emphasis supplied—Footnote omitted.]

These authorities support our denial of plaintiff's claim for the costs of the operation of its plant to the end of the contract term in connection with its non-federal work with its related companies, because such costs are too remote, speculative, and consequential to be compensable as damages. Of course, the plaintiff is entitled to recover its pecuniary loss of anticipated and unearned profits. The difficulty comes in determining what they are and how to calculate them. One complicating factor in this case is the fact that the plaintiff constructed a plant at a cost of $11,500,000 to perform the contract and to participate in its integrated operations.[6] The plaintiff still owns and operates the plant for the benefit of its integrated processes. The plant had a value at the time of the breach, not only as a physical structure, but also for furnishing helium and nitrogen-free gas and nitrogen to its related companies. The latter value is a value that is excess to the value of the physical structure. It is possible and probable that the fair market value of the physical structure at the time of the breach was in excess of the cost ($11,500,000) of the structure when it was built, especially after the structure was depreciated at five percent per annum. These excess values are values or benefits the plaintiff has received by reason of its performance of the Government contract and which it has not expended nor exhausted, but which it still owns, possesses and uses and will continue to use in its integrated operations. These excess values, whatever they may be, must be considered in calculating plaintiff's damages.

We hold that plaintiff's damages must be determined and calculated as follows:

(1) The excess, if any, of the fair market value of the physical plant at the time of the breach over the original cost of the plant ($11,500,000) depreciated in straight line depreciation of five percent per annum should be determined. The resulting figure represents the excess value, if any, of the physical plant at the time of the breach over the original cost of the plant depreciated.

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[6] It was estimated that had the Government built a plant for the extraction of helium, it would have cost $22,000,000.

(2) The excess value of the plant at the time of the breach occasioned by its continued operation in the "integrated" process of plaintiff and its related companies as an on-going operation for the extraction of helium and nitrogen and the furnishing of helium-nitrogen-free gas and nitrogen to plaintiff's parent and sister companies should be determined. This value is separate and distinct from the excess value, if any, of the physical plant over its depreciated original cost of $11,500,000.

(3) The excess value of the physical plant, if any, over the original cost of the plant depreciated should be added to the excess value of the plant as an on-going and functioning plant that is operating and will continue to operate in plaintiff's integrated operations. The sum of these two values represents the total excess value of the plaintiff in its helium plant that has not been expended nor exhausted by the performance of the contract with the Government, but is an asset or benefit conferred on the plaintiff by its performance of the Government contract and which it owned, possessed, and used at the time of the breach and still owns, possesses, and uses and will continue to own, possess, and use in the future in its integrated operations.

(4) The sum of the excess values described in (1) and (2) above should be added to the total stipulated anticipated manufacturing costs of $43,067,413 that the plaintiff would have expended to the end of the contract term. This addition results in the total anticipated costs and benefits of the plaintiff attributable to the helium contract; *i.e.*, total costs and benefits not spent by plaintiff because of the breach.

(5) The sum of the excess values of the plant and the anticipated manufacturing costs should be subtracted from the total anticipated revenues, before taxes, to the end of the contract period in the sum of $80,255,000. The resulting figure represents the anticipated profits from this contract to the plaintiff, subject to the following deductions.

(6) From the foregoing anticipated profits, the proceeds of the sale of helium to Kansas Refined Helium in the sum of $2,872,547, less any expenses properly proved up by the plaintiff as indicated above, must be subtracted, along with savings found by the trial judge of $11,000 per year to the

plaintiff if it did not operate the helium plant, and any other savings to it by its non-performance of the contract because of the breach. The resulting figure, discounted to current value as of the date of entry of final judgment, should place the plaintiff in as good a position as it would have been in had the contract been fully performed.

The plaintiff contends that the anticipated revenues from the contract should be escalated in accordance with the wholesale price index formula provided in Article 7.3(b) of the contract. We do not agree. In our opinion this Article would be applicable only in the event we awarded the plaintiff the full contract price as damages. Since we are awarding it only its anticipated profits as calculated above, the escalation Article is irrelevant and should not be applied after the date of the breach. After that date, the contract was terminated and of no further force and effect. There is no more reason to enforce the escalation Article than the Article dealing with damages in case of termination (Article 13). Furthermore, if anticipated profits are escalated, anticipated costs would have to be escalated also. In that case, the profits and costs would more or less offset each other. However, the anticipated cost escalation might exceed the profit escalation and this would be detrimental to the plaintiff. We hold that the escalation Article is not applicable. Accordingly, we do not reach nor decide the controversy between the parties as to the proper years to be selected as the base period from which to predict or project the probable escalation of the wholesale price index through 1983.

The plaintiff contends that it should be awarded interest on its award of damages to offset the discount to current value of its award. We recently considered the question of interest in an in-depth opinion in the case of *United States* v. *Mescalero Apache Tribe*, *ante* at 369, 518 F. 2d 1309 (1975), in which we held unequivocally that in non-condemnation cases interest cannot be awarded against the Government in the absence of a statute, treaty or contract providing for interest, and that this is true whether it is called interest, penalty, offset or damages. The instant contract does not provide for interest and we are without authority to award it. The interest claim is denied.

Judgment is entered for the plaintiff for its anticipated profits as damages for defendant's breach of contract in accordance with this opinion, and the case is remanded to the trial judge to determine such damages under Rule 131(c), and for other appropriate proceedings.

COWEN, *Chief Judge*, concurring:

The proceedings in this big and difficult case have reached the stage where the principal issue to be decided is the measure of damages that should be used to compensate plaintiff for the defendant's breach of contract.

The Uniform Commercial Code does not apply to this case; both parties agree that plaintiff's damages should be computed in accordance with common law principles, and the court has followed that course. Even if we were to look to the Code as a general guideline, we would be faced with a sharp dispute between the parties as to which of its sections relate to this case. Since the Code does not apply, we need not resolve this dispute.

Whether plaintiff is entitled, as it asserts, to recover the full contract price, or whether it should be compensated in accordance with the court's formula, is a mixed question of law and fact. The answer is necessarily a conclusion to be derived in substantial part from pertinent evidence and an interpretation of certain provisions of the contract.

The principal negotiators for the contract, which was executed on August 15, 1961, were Henry P. Wheeler, Jr., Assistant Director of the Bureau of Mines, who represented the Government, and F. C. Nicholson, who began his employment with Northern Natural Gas Company in 1958, and was a vice president of Northern during the negotiations. The testimony of these men and the reports and memoranda which they wrote shed much of the light provided by the record on the issue of whether, during the negotiations, defendant contemplated that, if it breached the contract, it would be responsible for the cost of continuing the operation of the helium plant.

Taken as a whole, the testimony of Mr. Nicholson[1] shows that the Government was not interested in nor did it inquire about plaintiff's cost of constructing the helium plant, the process to be used in extracting the helium, or the physical connection or relation between the helium plant and other units to be operated by Northern and its subsidiaries. The representatives of the Government assumed that the helium plant would be integrated with other facilities at Bushton, but the probability of such integration was not mentioned by the negotiators as a part of the consideration for the contract price. The Government's main concern was to acquire helium from plaintiff at less than the cost of recovering it in a plant constructed and operated by the Government. Thus, the contract price was developed on the basis of what it would cost the Government to produce helium in its own grass-roots plant—a plant independent of all other operations (Nicholson Tr. 503).

The testimony of Mr. Wheeler accords in all material respects with that of Mr. Nicholson. Mr. Wheeler stated that the contract price was negotiated, not on the basis of the cost of plaintiff's plant, but on what the cost would be if the Government constructed its own plant and removed the helium from the gas. He also testified that any references made by the representatives of Northern Helex to an integrated plant had no effect on the discussions relating to the contract price.[2]

In the operation of the helium plant, a nitrogen methane gas mixture is necessarily extracted in the process of recovering helium. In the early part of 1970, following changes in the contract between Northern and Gas Products, Northern began piping the nitrogen-methane mixture (referred to as a "high-nitrogen, low-B.t.u. stream") from the helium plant to the ethane plant. The purpose of this operation was to use the small amount of methane in the mixture as fuel and to reject or remove the nitrogen. The rejection of the nitrogen was not necessary to the physical operation of the ethane plant which could and did produce ethane without the removal of nitrogen. However, the nitrogen was removed so that the net B.t.u. value of the gas stream piped from the helium plant would not be reduced by the removal of the ethane. The gas residue was then piped into Northern's transmission lines for sale to its customers. Plaintiff's claim of entitlement to the full contract price is largely grounded on its contention that the continued extraction of nitrogen in plaintiff's helium plant is essential to the process by which the nitrogen is rejected in the ethane plant; that this was contemplated when the contract was executed, and that defendant then understood, or should have understood, that a breach of the contract would make it liable for the costs required to continue the operation of the helium plant. This contention is contrary to the following testimony given by Mr. Nicholson:

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[1] Nicholson Cross Examination Tr. 477–581.

[2] Wheeler Tr. 675–677.

"Q * * * The helium company was not at all concerned under its contract with the Government with the production of nitrogen, was it?

"A The helium company was not at all concerned with the production of nitrogen in the negotiations with the Government for helium." (Tr. 535)

The same conclusion is reached when one considers the facts regarding the construction and operation of the several facilities of Northern and its subsidiaries at the Bushton complex. Gas Products LPG plant is a self-supporting grass-roots plant which was built in 1961 to remove propane, butane, isobutane, and natural gasoline from the gas stream fed into it by Northern. The LPG plant can operate wholly independently of the helium plant. The helium plant made its first delivery to the Government on December 7, 1962. The original plans for the design and construction of the helium plant included special boilers which would burn the low B.t.u. fuel left after the removal of helium. However, the Federal Power Commission ruled that the nitrogen used in this manner would have to be valued as a fuel and costed on a volume basis. When this was found to be economically disadvantageous, plaintiff reinjected the low B.t.u. stream into the pipeline downstream from the helium facility.[3] This procedure continued until 1970, when the ethane plant began operations.

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[3] Trial judge's finding 111.

Near the end of 1966, Northern decided to begin the extraction of ethane and on July 3, 1967, filed an application with the Federal Power Commission requesting authorization for Northern to deliver additional volumes of gas to Gas Products for use in such extraction. Northern realized that the extraction of ethane would reduce the B.t.u. content of the gas stream sold to its utility customers, and in order to avoid a lengthy and complex hearing, Northern stated that nitrogen would be extracted from the additional volume of gas delivered to Gas Products to offset the B.t.u. loss. Northern also assured its utility customers and the Commission that the B.t.u. content of the gas stream which Northern had been delivering to its utility customers would not change by reason of the extraction of ethane.[4]

On June 26, 1967, about the same time the application to the Federal Power Commission was filed, the 1960 contract between Northern and Gas Products was amended to provide for the delivery by Northern of additional quantities of natural gas so that Gas Products could commence the extraction of ethane. The contract provided that in its ethane extraction process, Gas Products would not lower the B.t.u. value of the residual gas to be returned to Northern for sale to its customers.[5]

Construction of the ethane facility was begun in 1969, and the plant began operation early in 1970. Thereafter, gas leaving the LPG plant, which formerly had been piped directly to the helium plant, was piped into the ethane facility for processing prior to transmittal to the helium plant. The high-nitrogen, low B.t.u. stream remaining in plaintiff's plant after removal of the helium was then diverted to the ethane facility and used to fuel that plant's special boilers.[6] This diversion was made so that nitrogen could be removed at the ethane plant in compliance with the FPC order and Northern's assurances to the FPC and its customers that the B.t.u. content of its gas stream would not be lowered by the ethane extraction.[7] As previously noted, it is not physically necessary to remove nitrogen in order to extract ethane from natural gas.

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[4] Trial judge's finding 116.

[5] Trial judge's finding 127.

[6] Trial judge's finding 111.

[7] Trial judge's finding 116.

There is no provision in the contract between plaintiff and Northern, and there is no contract between plaintiff and Gas Products which states that plaintiff is obligated to remove nitrogen from natural gas.[8] Plaintiff receives no payment for that operation. The application, which Northern filed with the Federal Power Commission regarding the proposal for the extraction of ethane, made no reference to the extraction of nitrogen by the plaintiff nor was there any statement that plaintiff was so obligated in order to enable Gas Products to reject the nitrogen.

Several provisions of the contract further support the conclusion that the Government did not contemplate that, in the event it breached the contract, it would assume the obligation of continuing the extraction of nitrogen in the helium plant so that Gas Products could comply with its 1967 contract with Northern. Paragraph 1.1 of the contract provides that the term "plant" means the helium extraction plant to be constructed and owned by seller "whether completed or under construction and whether separate from or integrated with other facilities owned by Seller. * * *" This provision is another indication that the integration of plaintiff's plant with other facilities in the Northern complex was not a factor contemplated as a basis for future liability by the Government. It is an expression by the Government of a lack of concern as to whether the helium plant would be a purely independent plant or whether it would be integrated with other facilities.

I agree with Judge Skelton that the following articles absolve the Government from any liability for the cost of any operations or processes by Northern or Gas Products that may have been integrated with the helium plant: Paragraphs 31.2 and 31.3 of Article XXXI, which are quoted in the court's opinion, and Article XV, which provides that "each party will be responsible for its own acts and the results thereof."

While paragraph 31.3 of Article XXXI relates to the assumption by plaintiff of risks attributable to any additional facilities which it might construct during the term of the contract, I agree with the defendant's observation that it necessarily follows that if the Government was relieved of liability for any such facilities built by plaintiff, it was all the more freed of any liability on account of any other facilities built by Northern or others of its wholly owned subsidiaries after the contract was executed. This would include the facilities put in operation in 1970 by Gas Products to reject the nitrogen in the stream which, contrary to the procedure previously followed, is now diverted from the helium plant to Gas Products.

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[8] Trial judge's finding 125.

If, as plaintiff contends, the Government foresaw the necessity for plaintiff to continue the operation of the helium plant in order to permit the rejection of nitrogen in the ethane plant, one wonders why, during the negotiations, the Government made no inquiry about and was given no detailed information, such as a blueprint or diagram of the existing and planned facilities, or a description of the physical connections among the various plants operated or proposed to be operated by Northern and its subsidiaries at the Bushton complex. One also wonders why the Government, if it was to be bound by the contractual obligations entered into between Northern and the plaintiff and between Northern and Gas Products, did not insist that it be given copies of such contracts or proposed contracts at the time the negotiations were conducted. Northern, as sole owner of the subsidiaries, could amend its contracts with them at any time. Realizing this, the Government did not concern itself with these intercorporate contractual arrangements, because it did not contemplate that, in any event, it would be bound by them.

In my view, the facts which have been reviewed above clearly demonstrate that the Government did not foresee the liability which plaintiff would now impose upon it. Furthermore, it would be beyond the pale of reason to find that the Government should have foreseen risks resulting from the changing pattern of processes and operations of Northern and its subsidiaries after the contract was executed. The plaintiff itself did not decide to change the design of its helium plant until a ruling of the Federal Power Commission caused it to do so and to reinject the low B.t.u. stream into the downstream pipeline.

Until December 11, 1967, when the Federal Power Commission approved Northern's application of July 3, 1967, neither plaintiff, Northern, nor Gas Products knew that Gas Products would be required to reject nitrogen in the stream received from the helium plant in order to permit Gas Products to produce ethane from the additional gas to be delivered by Northern. Since these events occurred 6 years after the contract with the Government was entered into, how could the Government possibly have foreseen an obligation to keep the helium plant in operation in order to permit the rejection of the nitrogen?

The fallacy of plaintiff's position may be illustrated by the following: Let us assume that the contract was in full force and effect for a period of 12 years or until August 15, 1973, when it was breached by the Government. Let us also assume that near the end of 1971, Northern discovers a feasible process for recovering the nitrogen extracted by plaintiff in the production of helium and utilizing the recovered nitrogen as a feed stock for the production of ammonia. Northern thereupon creates a new wholly owned subsidiary corporation, builds a plant for recovery of nitrogen, and enters into a contract with the new subsidiary for that purpose. Then, for the second time after the contract with the Government was executed, a change is made in the diversion of the high-nitrogen, low B.t.u. stream from the helium plant, and the stream is now piped to the new nitrogen plant. After the contract is breached by the Government, plaintiff takes the position that the helium plant is now fully integrated with the new plant for the production of nitrogen; that the Government should have predicted and therefore should have foreseen these developments, and that it is now obligated to pay the full contract price in order that the helium plant may enable the nitrogen plant to carry out this newly integrated operation. Obviously, such a claim would be devoid of merit. In my opinion, plaintiff's claim for the full contract price is also without merit.

NICHOLS, *Judge*, concurring in part, dissenting in part:

I agree with much of the court's opinion, but dissent as to the vital matter of how we should treat the estimated projection of cost of performance of $43,067,413, as stipulated. The trial judge would not deduct this from the estimated contract revenues, nor would I. The court disagrees.

By UCC § 2–709, if the buyer wrongfully refuses to pay the purchase price, and the seller cannot sell the goods elsewhere, the buyer remains liable for the price. By UCC § 2–708 (1) and (2), the buyer is entitled to a credit for expenses saved the seller by the breach if, but only if, this measure is adequate to put the seller in as good a position as performance would have done. UCC does not directly govern here, but the above rules do not differ materially from those acknowledged by the court to apply at common law. So far as I can tell, we differ as to issues of fact, more than law.

If I contracted with Swift & Co. to buy all the squeal produced by its pigs, and if I reneged, I would not expect Swift & Co. to stop slaughtering pigs. I would, therefore, under the UCC, expect that Swift & Co. would go on slaughtering pigs, and any mitigating cost savings I could show would have to take that into account and probably would be slight indeed. Yet the court here, in an analagous situation, demands that the group with which plaintiff is affiliated, and with which it has integrated its operations, should stop producing natural gas. Because it does not do this, the court refuses to put plaintiff in as good a position as it would have been in upon full performance.

The record herein shows without contradiction that the Government always foresaw, and in a sense required, that plaintiff would integrate into a commercial natural gas production. Only thus could the cost be brought below the cost of a non-integrated operation. Absent such integration, and the cost savings to be expected therefrom, the Government would have preferred to produce helium in its own plants. To pretend that, under the contract, nothing but purchase of helium was involved, is to substitute a sterile legalism for the broad remedial relief the law prescribes against an unexcused contract breach.

The court puts on its blinders so as to be able to say it is putting the plaintiff in as good a position as it would have been in upon full performance, the standard it gives lip service to and should follow in reality. The court knows from the record that the three-stage refrigeration process at plaintiff's plant produces, at the third stage, about 295° F. and colder, a gas mixture, 72% helium and 27% nitrogen, which the Government bought, and a liquid residue, 26% methane, 73% nitrogen, and 0.01% helium, which is good only for fuel in special low-BTU boilers which exhaust this helium and nitrogen into the air. Plaintiff could not produce salable helium without producing these, too, and they, with the methane and the purified natural gas, are the usable products of plaintiff's plant now that the Government no longer will buy the helium. Stoppage of this plant would disrupt the other elements of the integrated system and apparently, cause a larger loss than the stipulated cost, $43,067,413, incurred by keeping open.

The Chief Judge's able concurrence became available only after I had written the above, and requires further specificity by me. I rely primarily on the trial judge's findings 26 and 79. Defendant did not except to these findings except in particulars not here relevant. It desired additions rather than deletions. They show that defendant elected to contract with plaintiff to obtain a reasonable cost to the Government, because the investment in the plant and operating costs "could be spread over several other end-products rather than helium alone", and would "avoid the necessity for the Government to undertake nitrogen removal and possibly petrochemical operations as a necessary, but basically unrelated, adjunct to helium conservation." Presumably this necessity of embarking in petrochemical operations in the suppositious Government plant was to spread the costs as a private, integrated plant would do. In the March 30–31, 1961, negotiations, plaintiff advised that the helium plant to be built would be "fully integrated" with the Bushton liquids recovery plant, and that "petrochemical facilities might be constructed and added in the future." Mr. Wheeler, government negotiator, "recognized that the helium extraction facilities would in most cases, be fully integrated with other facilities of the contractor."

Finding 125, following a description of the integration achieved after the contract date, reads in part: "All of these integrated operations are in implementation of Northern's original plans as executed through wholly owned subsidiaries." Defendant does not deny that this is true, in its exceptions, but says only it is irrelevant because the Government contract was not with Northern, *i.e.*, it is irrelevant because of the legal theory urged in Judge Skelton's opinion.

In view of this, I do not see how it can be said that the defendant could not have foreseen in general the measures adopted by plaintiff in 1970, as the Chief Judge describes them. Defendant's officials did not know exactly what plaintiff was going to do, but they expected plaintiff to exploit to the full all the capabilities of its helium plant. They could hardly have believed plaintiff would continue its pre-1970 procedure of feeding back into the pipeline downstream from the plant the useless and detrimental nitrogen it had gone to so much trouble and expense to extract. When plaintiff stopped doing this, had it done otherwise something else than what it actually did, that something else likely would have knit the helium plant into the other plants in a way that would have been costly to unravel. If it is true that before 1970, plaintiff could have stopped producing helium without damage to the other operations, this is because the integration in that period was incomplete.

The question is one of the inferences to be drawn from the record. Our trier of fact drew his inferences, and we are rejecting them, I believe, without respect for the presumption of correctness demanded by Rule 147(b). It seems to me that the implication of this rule is that we do not disregard numbered findings, but if we think the record does not support them, we take them up individually and show why. The Government did not in 1961 actually address itself to what the damage consequences of a breach would be. Finding 125 shows that a plan for integrated operation existed, substantially the plan actually implemented before the breach. Defendant knew the helium plant would be made part of an integrated operation which might include new petrochemical facilities. (Findings 26 and 79.) If the Government did not obtain the details, the fault was its own. However, it did not do this because it did not anticipate it was going to breach the contract. Therefore, it is chargeable with what it could have learned. The Chief Judge's argument seems to imply that a party to a contract who fails to inquire or consider what the consequences of a future breach by it will be, thereby limits its liability for damages in the event it actually commits such a breach. I do not think this is the law.

I do not get any help from Article XXXI, para. 31.3, quoted by the court. It is ambiguous whether the "risk" referred to is the risk of unexcused breach by the Government. The "legislative history" of the clause shows that the parties had entirely different kinds of risks in mind. American courts do not favor contract clauses to exculpate a party from the legal consequences of his own wrong. *The Bremen* v. *Zapata Off-Shore Co.*, 407 U.S. 1 (1972), deals with this policy. See especially the fn. in Mr. Justice Douglas's dissent at p. 24. Thus the clause here involved should be construed not to apply to the risk that a party might wilfully breach the contract.

I would be willing to give credit for the excess in the value of the plant over cost less depreciation at the time of the breach, if the court means just after it. However, in that event any deficiency in the fair market value, should also be charged to the Government. Presumably such deficiency, if it exists, is caused by the breach.

# CONGRESSIONAL REFERENCE

(The following Reports were filed pursuant to the Act of October 15, 1966, 80 Stat. 958, providing for the reporting of congressional reference cases by commissioners of the Court of Claims)

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# O'BRIEN DIESELECTRIC CORP. v. THE UNITED STATES

[Cong. Ref. No. 4-70. Filed July 29, 1975. Plaintiff's motion for re-hearing denied September 10, 1975]

### REPORT TO THE UNITED STATES SENATE

**Congressional reference; contract delay costs.**—The Chief Commissioner of the United States Senate pursuant to S. Res. 20, 91st Cong., 2d Sess., for a report giving such findings of fact and conclusions thereon, sufficient to inform the Congress of the nature and character of the demand as a claim, legal or equitable, against the United States or a gratuity, and the amount, if any, legally or equitably due the claimant. This reference involves claims for extra costs and delay encountered in the manufacture of generator sets for the Government. Initially, the issue of liability and damages, if any, were separated, the trial commissioner holding that the general release given by plaintiff embraced all manner of plaintiff's claims under consideration in 1960 and presently, whether legal or equitable, and not just claims of a legal nature. The Review Panel ordered reopening of proof as to damages, and remanded the case to the trial commissioner for findings on delay-costs with respect to certain specified matters. Following another trial and a second report from the trial commissioner, the Review Panel concluded that plaintiff has neither an equitable nor legal claim against the United States for the losses it incurred in performance of the contracts, and that viewed from the standpoint of equity in a broad nonjuridical sense of that term, relief provided by the United States from the contract losses would be a gratuity.

**Congressional reference; equitable claim; what constitutes.**

[1] The reference to "equitable claim" employed in 28 U.S.C. § 2509 is not confined to the strict legal definition of that term but embraces the concept of "equity" in a broad nonjuridical sense, and a

claim for equitable relief need not therefore be limited in all cases to circumstances where a wrongful act or omission of the Government is involved. The present congressional reference is not a case warranting equitable relief.

*Edwin J. McDermott*, attorney of record, for plaintiff.

*Lawrence S. Smith*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before SPECTOR, *Presiding Commissioner of the Review Panel*, WHITE, *Senior Commissioner*, and COLAIANNI, *Commissioner*.*

OPINION**

BY THE REVIEW PANEL: The United States Senate, by S. Res. 20, 91st Cong., 2d Sess., referred S. 266 to the Chief Commissioner of the U.S. Court of Claims, a Bill "for the relief of the O'Brien Dieselectric Corporation" pursuant to 28 U.S.C. §§ 1492 and 2509 (Supp. V, 1965–69). The Chief Commissioner referred the case to Trial Commissioner C. Murray Bernhardt for proceedings in accordance with the Rules, and designated the named members of the Review Panel to consider the Trial Commissioner's opinion.

Following a trial, Commissioner Bernhardt, in an opinion filed September 19, 1972, concluded:

> * * * [T]hat the general release given by plaintiff embraced all manner of plaintiff's claims under consideration in 1960 and now, whether legal or equitable, and not just claims of a legal nature. The matter is mooted, of course, by the earlier conclusion that the claims presented in 1960 and now were all of a "legal" nature, and that no merits have been established deserving equitable consideration.

Order of the Review Panel, following oral argument on plaintiff's exceptions to the Trial Commissioner's opinion,

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*Section I of the Rules notes that: "Except as the use of the statutory designation of 'commissioner' may be required, the commissioners of this court shall, in the performance of their duties and the exercise of their functions, be known and referred to by the title of "Trial Judge. * * *"

It is deemed that the statutory designation is still required in Congressional Reference cases.

**The separate findings of fact accompanying the opinion are not printed since such facts as are necessary to the decision are contained in the opinion.

reopened proof as to damages and remanded the case to the Trial Commissioner for findings on delay-costs attributable to:

> a. The specification of heaters "similar and equal to Superfex Model 480 series as manufactured by Perfection Stove Co." (Finding 16)
>
> b. The fact that there "was no other type of heater available from other manufacturers that was equal to the Perfection model referred to * * *." (Finding 16)
>
> c. The fact that "[d]emand for the heater, of which Perfection was the sole source of supply, was heavy due to contemporaneous orders under other Government contracts" (finding 16), and consequent delays due to the allocations and priorities system then in effect because of the Korean conflict. [1]

After another trial, Commissioner Bernhardt, in a second opinion filed December 19, 1974, made additional findings and concluded that:

> * * * [T]he plaintiff has not estabalished that it was effectively delayed by the heater problem. * * * This conclusion, which was implicit in the earlier liability opinion and findings, is independent of the release defense upon which the Trial Commissioner's previous rejection of the claim was primarily predicated. * * *

This opinion follows the filing of plaintiff's exceptions to the Trial Commissioner's second opinion of December 19, 1974, and oral argument thereon. While the Review Panel agrees generally with the ultimate conclusion of the Trial Commissioner, it deems it appropriate to state its opinion and conclusions somewhat differently. In doing so, we have borrowed heavily from Commissioner Bernhardt's opinion and findings of fact.

### *The Release Issue*

The Bill (S. 266), which S. Res. 20 referred to the Chief Commissioner, directs payment to plaintiff of $192,000 "in full satisfaction of all claims * * * against the United States for reimbursement for losses incurred under" three contracts awarded plaintiff in June 1951 by the United States, such losses having occurred as the result of a delay by the United States in issuing a modification order to one of the contracts, the failure of certain other companies [plaintiff's suppliers] recommended or designated by the United States, to provide certain items and test equipment necessary to the performance of such contracts, and other unforeseeable circumstances * * *."

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[1] A memorandum of pretrial conference filed June 9, 1971, recorded that the "liability issue is tentatively severed from damage issue for initial disposition."

Defendant's answer herein is responsive to a petition detailing the allegations of plaintiff's claim for legal or equitable relief. The answer does not, however, plead release as an affirmative defense. Moreover, Senate Report No. 91–1309 accompanying S. Res. 20 observes that:

> The Department of Justice opposes the enactment of S. 1090 [a prior and similar bill] for the reason that claimant should be barred from further relief because of the settlement made by it and the Government in the suit tried in the Court of Claims.
>
> For reasons before and hereinafter stated, the committee does not feel that the settlement made by claimant and the Government in the Court of Claims bars relief.
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> * * * * *
>
> The fact that a judgment is entered on the release and paid by the United States is argued to constitute res judicata but that situation has been before the U.S. Court of Claims many times, and the court has, without hesitation, recommended the granting of equitable relief by Congress despite prior judgment on the merits [citing cases].
>
> * * * * *
>
> The committee is of the view that the settlement entered into by claimant and the Government in the Court of Claims was only a settlement of the legal claims based on breach of contract and was not a settlement of the moral and equitable claims of claimant, such as they may be.
>
> The authorities hold that a settlement or release in such circumstances does not bar congressional relief based on equitable considerations. [Citing cases.]
>
> * * * * *
>
> Favorable action on this resolution would be in accordance with established precedents, as noted above.

The foregoing notwithstanding, testimony was taken at the first trial regarding earlier litigation, and its possible bearing as a release of this Congressional Reference case seeking equitable relief.

As is not uncommon, this petition for equitable relief was preceded by prior unsuccessful attempts to secure relief within the contracting agency, and thereafter in a conventional suit for breach of contract in this court. Plaintiff, in November 1953, first sought an increase in contract price on the equitable grounds set forth in Title II of the First War Powers Act of 1941.[2] The claim was turned down in August 1954. It then filed claims with the agency on legal grounds, pursuant to the "Disputes" clause contained in each contract. They were denied by the contracting officer and, in April 1957, by the Armed Services Board of Contract Appeals representing the Secretary of the Army.

Prior to that board decision plaintiff, on May 23, 1956, filed a petition in this court alleging breach of contract. During pendency of that action for damages in the amount of $225,000, it offered to settle certain of the claims for $37,000 and to waive the remainder. Defendant counteroffered to settle the case for $7,500. As a result of settlement negotiations, on July 25, 1960, during trial, the parties agreed to settle for $8,250 and a stipulation to that effect was filed August 30, 1960. The stipulation recited that plaintiff had agreed to accept that sum in full settlement of all claims set forth in the petition, and that it supported a judgment in that amount to plaintiff.

At the first trial of this Congressional Reference case, and notwithstanding the above-quoted Senate Report and the absence of a release defense in the answer to the petition, the issue of release was raised. Mr. O'Brien of plaintiff company testified that while the breach of contract trial was suspended for settlement negotiations on July 25, 1960, the Trial Commissioner had stated to him from the bench that most of the allegations in plaintiff's petition were not within the court's jurisdiction; and that later off the bench the Trial Commissioner had explained that most of plaintiff's claims belonged in a court of equity.

Counsel, who were out of the courtroom at the time, have differing versions of their intent in settling the breach of contract action. Plaintiff's counsel stated he had intended to settle only those claims set forth in paragraphs 7 through 9 of that petition, and believed that the balance of the claims were beyond the court's regular jurisdiction; that the only remedy was via a Congressional Reference as in the instant proceeding. Defendant's counsel stated that at the 1960 settlement conference, plaintiff's counsel wanted to settle the whole case because he thought it weak, and defendant's counsel thought that the $8,250 he recommended applied to settlement of the entire claim, and not merely elements of it.

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[2] *As amended*, 55 Stat. 838, 839; 64 Stat. 1257.

In any event, it is obvious that this reference by the Senate does not evidence an intent that we go off on that issue. The Bill, the Senate Resolution and the Senate Report, in fact, evidence a contrary intent. A significant number of Congressional Reference cases are referred by the Congress for the very reason that a release, or the running of the statute of limitations, otherwise constitute a bar to consideration of the case at law and on its merits.

The cases cited and discussed in the Senate Report are typical, and support that conclusion. So also does *Adler Constr. Co.* v. *United States*, 199 Ct. Cl. 809 (1972).[8] It is therefore not deemed appropriate nor necessary to enter upon the threshold issue of the release as raised at trial, nor to resolve the conflict in the understanding of the parties as above-summarized.

### *The Issues on the Merits*

In the spring of 1951, Mr. O'Brien, President of O'Brien Machinery Company of Philadelphia, in business since 1915, learned that the Philadelphia District of the Army Corps of Engineers was planning to buy 600 portable, diesel-driven electric generator sets urgently needed by the Air Force for use in Korea. Each set was to consist of a diesel engine, a generator, a control panel, heaters with winterized accessories, a skid base, and a weather resistant housing. A purchasing agent for the District, Mr. Buchanan (since deceased) advised that the sets were of a standard type except that they were to be "winterized" by means of heaters and heat ducts to permit startup and operation at a minimum temperature of -65° F. In this respect they were somewhat, but not unduly, novel.

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[8] In the same case, at an earlier state, 191 Ct. Cl. 607, 423 F. 2d 1362 (1970), plaintiff's petition had been dismissed under the regular jurisdiction of this court by reason of a release, and on legal grounds. It was returned to us as a Congressional Reference for consideration as a claim for equitable relief under the same statutory authority governing consideration of this case.

Testing facilities for the winterization features were scarce. Mr. Buchanan further advised Mr. O'Brien that the Perfection Stove Company could provide heaters of the type required, as well as design and furnish winterizing accessories and ducts for the heaters, tailored to the particular requirements of the generator set, for about $325 per set plus a modest development cost. Mr. Buchanan also told Mr. O'Brien that the engine to be used for the generator set would require approval by the Corps of Engineers at Fort Belvoir, and that General Motors had been soliciting the District to use their Series 71 engine, which they said was immediately available. As a purchasing agent, Mr. Buchanan had only limited authority to make representations which would be binding on the contracting officer.

In April 1951, O'Brien Machinery Company joined with Electric Machinery Manufacturing Company (a manufacturer of electric generators) to form plaintiff corporation and bid on the forthcoming procurement. Factory space was leased by plaintiff from O'Brien Machinery Company. Bids were invited in June 1951 for the 600 sets. After soliciting prices and delivery data from various suppliers, including a General Motors distributor of diesel engines (Frantz Equipment Company), plaintiff submitted a bid on June 16, 1951. Plaintiff had not previously contacted Perfection Stove Company to corroborate the other information furnished by Mr. Buchanan as to the heaters and winterizing kits.

The specifications called for heaters "similar and equal to Superfex Model 480 series as manufactured by Perfection Stove Co." The "similar and equal" language was meaningless since the Government concedes that there was no other type of heater equal to the one specified. Perfection was the sole source of supply, and demand for the heater was heavy due to contemporaneous orders under other Government contracts. Specifications for the winterization accessories other than heaters were of the "performance" rather than of the "design" type.[4] No drawings were provided by the Government, that being an obligation of the contractor.

Mr. O'Brien's testimony on whether he examined the specifications prior to bidding is inconclusive. Plaintiff understood the winterization aspect to be somewhat novel, and it planned to subcontract all of the separate components of the generator sets, thereafter assembling and testing the required pilot model and production units with its own work force. O'Brien Machinery Company had theretofore built conventional generator sets, but not under Government contract, and without winterization features.

Although plaintiff's was the lowest of six bids, it and three other bidders were subsequently advised that the 600 units would not be awarded to the low bidder but that four separate contracts would be negotiated with four selected bidders for 150 units each. On June 26, 1951, plaintiff received contract DA 36–109–ENG–957 (hereinafter contract 957) for 150 skid-mounted diesel-driven portable electric generator sets, for delivery by April 1, 1952. On June 27 and 28, 1951, plaintiff was also awarded contract DA 36–109–ENG–961 (hereinafter 961) for 40 skid-mounted portable generator sets driven by gasoline engine; and contract DA 36–109–ENG–1052 (hereinafter 1052) for four trailer-mounted, gasoline-driven generator sets. None of these three contracts contains a provision permitting the agency to afford administrative monetary redress for Government-caused delays. The standard "Changes" clause contained in each contract authorizes an equitable adjustment of contract price and performance time for changes in the specifications and drawings ordered by the contracting officer; and the standard "Default" provision relieves the contractor from responsibility for delays which are beyond its control and without its fault or negligence.

By reason of difficulties hereinafter described, deliveries under contract 957 (for 150 diesel-driven generator sets scheduled for completion April 1, 1952) actually began May 15, 1953, and were completed August 21, 1953. Under contract 961 (40 gasoline-driven units scheduled for completion December 15, 1951) deliveries actually began December 19, 1952, and were completed January 23, 1953. The four gasoline-driven units under contract 1052, scheduled for completion November 30, 1951, were actually delivered January 20, 1953. Plaintiff was afforded time extensions, but not monetary relief, for the delays which were deemed beyond its control and without its fault or negligence.

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[4] That is, they specified results desired, rather than the specifics for accomplishing those results.

Plaintiff was adequately staffed and equipped to perform these contracts, and the units it produced and delivered were considered superior in quality. The other three contractors mentioned earlier also encountered severe difficulties in varying degree. (*See*, for example, *Bolinders Co.* v. *United States*, 139 Ct. Cl. 677, 153 F.Supp. 381 (1957), *cert. denied*, 355 U.S. 953 (1958).) There then followed plaintiff's unsuccessful application for equitable and then legal relief before the Army, and plaintiff's suit for breach of contract and this application for relief by Congressional Reference, as earlier described.

## A. THE DIESEL ENGINES

The petition adverts to certain alleged misrepresentations by the Government as to the diesel engines required for the 150 generator sets under contract 957. Upon receiving that contract, plaintiff conferred with the General Motors distributor (Frantz Equipment Company) regarding the GM diesel engine earlier mentioned by Mr. Buchanan as being suitable. The contract did not specify any particular engine.

On July 6, 1951, Frantz offered to supply 150 GM diesel engines but warned that it could not guarantee that the engine would comply with the design and performance requirements of the specifications, and that it would not accept responsibility for noncompliance. Frantz offered to start deliveries August 8, 1951, with one engine for plaintiff's pilot model, and to complete deliveries in February 1952. Because of uncertainty as to whether the GM engine conformed to the specifications, plaintiff, on August 7, 1951, ordered 151 diesel engines from International Harvester Company. The first

Harvester engine was delivered January 25, 1952, and was incorporated in a pilot model generator set assembled for testing by February 25, 1952. Another Harvester engine was shipped to plaintiff on March 17, 1952.

Thereafter, no more engines were shipped to plaintiff by Harvester until November 25, 1952. In the interim (March 17 to November 25, 1952), Harvester had plaintiff's pilot model generator set in its possession for testing during the period April 28 to June 5, 1952. Certain deficiencies had developed in the engine, including the governor mechanism. Although plaintiff contends that those deficiencies were attributable to a strike at Harvester's plant from July 3 to November 15, 1952, during which engine pumps were said to have been left on the shelf too long, those difficulties with the engine were experienced prior to the beginning of the strike.

As later detailed, the engine was then sent to Hill Diesel Company for altitude testing, and to Perfection Stove Company on July 10, 1952, for cold testing and fabrication of winterization equipment. These factors, plus the Harvester strike, account for the delay in shipments of Harvester diesel engines from March 17 to November 25, 1952. Shipments were completed on July 31, 1953. None of these factors contributing to delay in receipt of diesel engines for contract 957, are attributable to Government action or inaction.

Mr. Buchanan's precontract comments with respect to the GM diesel engine did not amount to an actionable misrepresentation that the engine mentioned would meet the specifications. Moreover, he was not authorized to speak for the contracting officer. There is no evidence of any independent investigation of the suitability of the GM engine by plaintiff, prior to bidding. The data acquired from the GM distributor related only to price and delivery. Even if deemed, *arguendo*, to be a misrepresentation, the total delay attributed to Mr. Buchanan's statements would not exceed 1 month, starting July 6, 1951, when plaintiff learned the GM engine could not be warranted for compliance, and ending August 7, 1951, when plaintiff placed its order with Harvester. In summary, the truly significant delays in procuring diesel engines suffered by plaintiff grew out of its subcontract with Harvester, and were not chargeable to Government action or omission.[5]

### B. The Heaters and Winterization Kits

Plaintiff also attributes delay to Perfection Stove Company in supplying it with heaters and winterization kits. This claim is similarly confined to contract 957 for the 150 diesel-driven sets.[6] As previously mentioned, the specifications were explicit as to the heater, requiring Superfex Model Series 480 made by Perfection Stove Company, which was the sole source of supply for this item. Perfection was loaded down with contemporaneous orders under other Government contracts.

It was August 22, 1951, about 2 months after it received award of contract 957, that plaintiff issued purchase orders to Perfection to design, develop and furnish 150 winterization kits. The cost was not to exceed $4,000 each, including testing. Perfection estimated that after it received a pilot model of the diesel generator set it would take 1 month to develop a winterization kit, another month to complete drawings and specifications, and 6 weeks thereafter to begin deliveries.

Plaintiff shipped a pilot model of the *gasoline* generator set to Perfection on March 7, 1952, and promised to ship the pilot model for the diesel generator shortly thereafter. However, the diesel pilot model was not received by Perfection until July 15, 1952. It could not design the winterization kit until it had in its possession a pilot model which had itself previously passed the altitude test and a cold test. Plaintiff had sent its pilot model to Hill Diesel for altitude testing on June 5, 1952, but defects in the diesel engine, as previously described, frustrated completion of the altitude test, thereby deferring delivery to Perfection until July 15, 1952.

Perfection had first to perform cold room tests on the pilot model before winterization kits could be produced in quantity, and Perfection was not equipped to carry out all the required cold room tests. Due at least in part to additional problems encountered with the diesel engine and electrical system, the cold room test on the pilot model was not completed until September 5, 1952.

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[5] Although plaintiff makes no claim with respect to delays in obtaining gasoline engines from Continental Motors Corporation for contracts 961 and 1052, Continental's failure to ship gasoline engines on schedule also delayed submission of that pilot model generator set for testing and, therefore, also delayed completion of contracts 961 and 1052.

[6] Plaintiff ordered 44 winterization kits from Perfection for contracts 961 and 1052, which were delivered in June and July 1952. There is no claim of delay as to them.

At that time it was first discovered that a Series 590 heater, rather than the Series 480 specified in the contract, would be required. The Series 590 cost an additional $163 per heater.[7] Perfection provided plaintiff with sketches for the winterization kits (for both diesel and gasoline generators) October 1, 1952. On October 24, 1952, plaintiff cancelled its purchase order to Perfection for the 150 winterization kits for the diesel generators under contract 957 and decided to fabricate the kits itself, using Perfection Series 590 heaters, and certain accessories still to be provided by Perfection.

Accordingly, plaintiff issued a new purchase order to Perfection December 9, 1952, for the items it needed to proceed with winterization kits, namely, 150 of the Series 590 heaters, battery temperature controls and oil sump thermostats. It paid Perfection a cancellation charge on the first order. Delivery was now promised in 4 to 6 months, due to the priority of orders under other contracts including Air Force contracts. Prior to cancellation on October 24, 1952, of the first order for the complete winterization kits, Perfection had been obligated to deliver within 18 to 20 weeks after receipt of that original order.

By early January 1953, the District was threatening default termination of the diesel generator contract, originally scheduled for completion April 1, 1952. As a result plaintiff was putting pressure on Perfection to deliver the required heaters and accessories. They were delivered between January 26 and May 29, 1953, the bulk of them on March 18 and April 10, 1953. This was within the 4 to 6-month period promised by Perfection with the second purchase order.

Plaintiff had proceeded to fabricate its own winterization kits (without heaters and accessories) on December 10, 1952.

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[7] No change order was issued to cover the more expensive heater and the record is incomplete on this point. No claim appears to have been made for the apparent additional cost of $24,450 (150 x $163).

There is no direct evidence as to when plaintiff had reached a point of completion where it was waiting for heaters and accessories from Perfection to assemble them into complete generator units. Generally, the shipment to the Government of complete generator units followed receipt of heaters from Perfection by about 4 months, indicating that was the average time required for plaintiff's assembly operations. There is no evidence as to whether this was a normal or excessive period of time. In any event, deliveries of end items under contract 957 were accomplished between May 15 and August 21, 1953, more than a year after the originally scheduled completion date of April 1, 1952.

An important Government witness agreed that lack of winterization equipment was plaintiff's biggest problem, and was the most important cause of the overall delays suffered. However, there is no evidence that Perfection Stove Company was responsible for the delays in furnishing winterization equipment for use in final assembly. Perfection was, in turn, delayed in receipt of a pilot model, which had in turn been delayed by diesel engine problems, as earlier described.

### C. Cold Tests

There were other concurrent and included delaying factors which contributed to plaintiff's problems, but they appear to be of secondary importance, when compared with those already mentioned. Although Perfection had been designated as sole source for the heaters, it had not been so designated with regard to performance of cold tests, a problem intimately related to the heater and winterization kit problems just described. The contract lodged responsibility in the contractor for performing cold tests of startup and operation of both types of engines under the three contracts. Perfection, as subcontractor, did not have the cold testing facilities to perform all the specified tests and it so informed plaintiff October 22, 1951. Production of winterization kits could not proceed until cold tests had been satisfactorily concluded.

The District waived certain cold tests Perfection was not equipped to make, and the pilot models for the gasoline generator sets (contracts 961 and 1052) were successfully tested

March 25, April 2 and 3, 1952, and approved May 14, 1952.[8] A similar waiver was made for contract 957 covering the 150 diesel generators, but cold tests were delayed by other factors. As previously explained, the diesel pilot model was received by Perfection July 15, 1952, from Hill Diesel Company where it had been held up awaiting altitude testing. The District would not approve altitude tests until cold tests had been approved. Based on cold tests conducted August 27, 28 and September 4 and 5, 1952, Perfection reported that the pilot model was in compliance, subject to waiver of some tests. But in its report, Perfection noted an unusual number of "deficiencies in the adjustment, calibration and general assembly of the unit." The pilot model was shipped by Perfection to plaintiff October 9, and was received October 16, 1952.

### D. Contract Modification No. 2

Plaintiff alleges that the Government delayed 6 months in issuing contract modification No. 2 which changed the mounting for the gasoline generators under contract 961 from skid to trailer, and thereby delayed plaintiff's performance. Shortly after award of this contract, the Engineer Supply Control Office on July 20, 1951, wrote the District to suspend action pending receipt of the above change in mounting, and certain revisions to provide a compartment and hooks for a power cable to be Government-supplied. Drawings and photographs of the required changes were furnished, and plaintiff was asked to quote price and delivery date, which it did August 3, 1951. Specifications were furnished, and plaintiff was instructed to order the Government-supplied power cables and ground rods 30 days prior to scheduled delivery of the completed generator sets. Plaintiff was instructed to proceed and did. But, on November 15, 1951, it requested that the actual confirming, written change order be issued, or it would stop work. The Government complied on December 3, 1951, when modification No. 2 was issued and accepted by plaintiff.

The delivery schedule set forth therein required completion of the pilot model December 17, 1951, with deliveries at the rate of 10 per week from January 7 to February 15, 1952. On January 23, 1952, plaintiff placed an order for the 40 trailers required with Truck & Trailer Equipment Company, specifying immediate delivery of one for the pilot model, and of the remainder starting March 15, 1952. The first trailer was actually shipped April 30, 1952, and the remainder from September 25 to November 6, 1952. Since plaintiff began work on this modification before receipt of the formal modification order, delay in issuance of that formal order did not delay the actual work.

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[8] Plaintiff was instructed to adjust the battery box bypass.

As previously stated, modification No. 2 also required design and fabrication of a special compartment or housing for a Government-supplied power cable. The Government delayed in supplying the cables, or specifications describing them, for over a year, with the result that plaintiff finally designed and fabricated the cable housing itself.

Since plaintiff informed the Government it was ready to ship all 40 generator sets under this contract 961 by November 26, 1952, delays attributable to the cables must have been resolved by that date at the latest. The District did not permit plaintiff to ship by November 26, 1952, stating that production tests were necessary before shipment, and that the pilot model test had not been completed. The 40 generator sets were shipped to the Government at various times from December 19, 1952, to January 26, 1953.

It is not readily apparent that lack of Government-supplied cables prevented earlier delivery under contract 961, as plaintiff contends, since it seems likely that plaintiff's letter of November 26, 1952, announcing its readiness to deliver would have otherwise made mention of the prior cable delays. The Government's prolonged failure to deliver cables or specifications for same to plaintiff was inexcusable, but it does not appear to have caused significant overall delay in plaintiff's performance, when measured against other contemporaneous problems plaintiff was experiencing on the 150 diesel generator sets, as earlier described.

The presence of 40 completed gasoline generator units in plaintiff's plant, awaiting permission from the Government to ship, did prevent plaintiff from using that plant space to work on the 150 diesel units under contract 957, as plaintiff contends. But the Government was entitled to a reasonable time within which to test the pilot and production models prior to giving plaintiff instructions to ship, and there is no proof that the time taken by the Government for this purpose was unreasonable.

In summary, late issuance of formal written modification No. 2, and tardy furnishing of Government-supplied cables are not condoned, but they were not wrongful acts or omissions causing major delay, such as to warrant favorable consideration of this claim for equitable relief.[9]

### E. Radio Interference Suppression Tests

These tests were to be performed by the Government on the pilot models for all three contracts. Plaintiff alleges it was delayed by the Government's failure to perform them at Fort Monmouth, New Jersey, in a timely manner.

On October 16, 1952, the pilot model for the contract 957 diesel generator was returned after having been cold tested at Perfection Stove Company. On November 7, 1952, the District requested the Signal Corps Laboratory at Fort Monmouth to perform these radio tests on the pilot model scheduled to be delivered by plaintiff on November 12, 1952. The laboratory report sent to plaintiff on January 6, 1953, concluded that the generator set conformed to the radio interference suppression specifications, but it described objectionable interferences traced to the battery charging regulator and the output load circuit breaker, requiring special shielding and adjustments.

On January 7, 1953, plaintiff informed International Harvester, supplier of the diesel engine, that "rather drastic changes" had to be made in the Harvester engine. Harvester was further asked what action it would take in light of plaintiff's obligation to furnish the additional equipment recommended by Fort Monmouth. Plaintiff does not charge the Government with delay in the latter's discharge of its responsibility for performing the radio interference suppression tests on the diesel generator set.

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[9] It is presumed that modification No. 2 provided the equitable adjustment in contract price and time required for the explicit changes it ordered.

On September 16, 1952, the District orally arranged to have the same test performed on the pilot model for the gasoline generator sets, delivered by plaintiff September 17, 1952. In its report dated October 24, 1952, the laboratory concluded that it met specification requirements, but it also described a number of defects it had encountered and corrected prior to achieving compliance. Plaintiff was instructed to correct these discrepancies on production items.

Plaintiff's contention that it was delayed in delivering completed gasoline generator units from September 6 to November 6, 1952, by this test, is not supported by the record. At most the test took from September 17, when the pilot model was delivered, to October 24, 1952, when the report on the test was issued. Absent any additional evidence on conditions at the Fort Monmouth Laboratory, it cannot be said that this 37-day period was unreasonable.

### F. Altitude Testing

The specifications provided that where the contractor lacked facilities for performing altitude tests, they "shall be conducted in a Government laboratory to be designated by the contracting officer, and shall be performed after all other development tests have been completed." Since the tests were required in all three contracts, and plaintiff lacked such testing facilities, it requested the District to locate and designate a suitable facility. After some unsuccessful efforts, the diesel pilot model was sent to Hill Diesel for altitude testing on June 5, 1952, but defects in the Harvester engine prevented completion of the test. On December 18, 1952, permission was given to use Navy testing facilities at the Philadelphia Naval Base and the tests were conducted there on January 23, 1953. The tests failed, and the pilot model was returned to plaintiff for correction.

The corrected generator set was returned and retested April 9, 1953, but a defective switch caused a cooling problem. After the cooling system was modified by plaintiff, the pilot model passed the final altitude test on April 16, 1953. There is some question as to the adequacy of the Government's testing facilities, and as a result there was a partial waiver of test requirements. The delays originating in this test, however, were due essentially to deficiencies in the unit. It is noteworthy that the same test on the gasoline pilot model was performed by Hill Diesel several months prior to the test on the diesel unit, and there is no evidence with respect to test delay on the two contracts for gasoline-driven generator sets.

### G. Delco Generators

Plaintiff alleges it was delayed by Government delay in approving its Delco motor, *i.e.*, generator. Prior to July 3, 1951, Delco Products Division of General Motors orally offered to supply the generator components for the two types of generator sets. It further offered to furnish the two pilot model generators in September 1951, and to begin production deliveries 60 days after approval of the pilot model, and to complete them in February 1952.

Plaintiff ordered the 150 generators required for contract 957 on July 13, 1951, and the 44 generators required for the other two contracts on August 28, 1951. On November 26, 1951, Delco asked plaintiff to apply to the Government for priority assistance in procuring controlled materials to produce the generators. The Korean War had resulted in adoption of a controlled materials plan to allocate scarce supplies. Plaintiff transmitted the request to the District for action. The District had previously, and on July 23 and August 7, 1951, notified plaintiff that a Defense Order rating had been assigned to the three contracts placing them in a preferential category.

On December 27, 1951, the Government approved the pilot model generator for contracts 961 and 1052. Delco shipped two of these generators to plaintiff on December 28, 1951, and 10 more on January 17, 1952. Although Delco wrote plaintiff on January 25, 1952, expressing appreciation for plaintiff's allowing it to schedule deliveries, since the generators were in stock and ready for shipment and, although the same letter announced that 30 more would be shipped by February 18, 1952, only 15 were shipped on January 31, 1952, and the remaining 15 were not shipped until September 15, 1952. However, it appears that Delco was ready, willing, and able to ship the generators for contracts 961 and 1052 to plaintiff long before plaintiff could use them, and that Delco complied with its delivery responsibilities on these two contracts.

As for the 150 generators ordered July 13, 1951, for contract 957, although the pilot model of the generator was formally approved by the District on December 30, 1952, that approval was on the basis of test reports to the District a year earlier on December 27, 1951. Although incomplete, the record shows that on the strength of the test reports, 43 generators were delivered by Delco from January 24 to April 25, 1952, and 50 more were delivered on or about March 31, 1953. On June 18, 1953, plaintiff sent an urgent wire to Delco requesting immediate shipment of the balance of the 150 generators required for contract 957 and Delco promised them by June 24, 1953. When the rest were actually delivered is not shown.

In any event, the evidence fails to establish that any delay on the part of the Government in formally approving pilot models of the Delco generators for any of the contracts was the cause of delayed delivery of generators by Delco to plaintiff. Delivery of the contract 957 generators began January 24, 1952, presumably on the basis of the test reports of December 27, 1951.

### H. *Other Miscellaneous Causes of Delay*

Brief mention is made of other possible causes of plaintiff's delay problems which were mentioned in its claims before the contracting agency, but not thereafter pursued in this and the prior litigation. Those possible delaying factors, not previosly mentioned herein, are:

> (a) Housings for the generator sets. Plaintiff had to cancel its first subcontractor because of the latter's deficient workmanship; and its second subcontractor was also delayed in performing.
>
> (b) Costs of extra sets of test reports supplied at Government request but not required by the contracts.
>
> (c) Price reduction for partial payments.
>
> (d) Strike in plaintiff's plant in spring or summer 1953 affecting performance of contract 957.

It can be seen from all of the foregoing that plaintiff experienced a number of unfortunate delays, many of them due to circumstances "beyond the control and without the fault or negligence of the contractor."[10] Such delays can support extensions of time within which to perform, and relief from a threat of default termination, but under the terms of this contract they would not ordinarily support a claim for monetary relief grounded on delays. To support a money claim, the delays would have to be attributable to direct acts or omissions of the Government acting in its contractual (rather than sovereign) capacity.[11]

Tracing through the tangled skein of delaying factors from which these contracts suffered, it is apparent that the overriding cause of plaintiff's problems originated in the heaters and winterization kits. Both parties seem to agree on that. It is true that the only heater that was in compliance was a proprietary item of Perfection Stove Company, and that Perfection had been specified as a sole source by the Government. It is also true that when Perfection finally received a pilot model on which it could design a winterization kit, it found that a different model of its heaters would be required than the one specified. But delay in delivery was not the fault of this designated sole source supplier. Perfection had itself been delayed by deficiencies and delays affecting the diesel engine, and those were causes not attributable to Government action or inaction.

There is, by way of further example, no explanation for plaintiff's delay in ordering heaters from Perfection for 2 months after award to plaintiff of contract 957 for the diesel-driven sets. Perfection could not design the winterization kits nor supply the heaters until plaintiff had provided a pilot model containing a diesel engine, and until that pilot model had in turn passed a cold test and an altitude test. Although the above recital of facts indicates that Government administration of these urgent contracts was not in all respects exemplary, the root causes of the delays and consequent increased costs were defects in the diesel engine, tardily supplied by Harvester. This delayed the altitude and cold tests on the pilot model until September 5, 1952.

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[10] Quoted from General Provision 10 of the contract, "Default."

[11] *See & cf. Horowitz* v. *United States*, 267 U.S. 458 (1925).

Some 25 days later (October 1, 1952), Perfection had designed the required winterization kit, and had concluded that a different model of its heater from that specified would be required. There is no evidence that this 25-day period for design of the winterization kit was unreasonable; nor is there any evidence that plaintiff was delayed by the determination that a Series 590 heater was required instead of the Series 480 originally specified. There is, moreover, some indication that plaintiff's decision thereafter to cancel the original Perfection subcontract on December 9, 1952, and to fabricate the winterization kits itself, may have been ill-advised and ultimately served to delay rather than expedite end item deliveries under plaintiff's contracts.

Although the reference to "equitable claim" employed in 28 U.S.C. § 2509 is not confined to the strict legal definition of that term but embraces the concept of "equity" in a broad nonjuridical sense,[12] and although a claim for equitable relief need not therefore be limited in all cases to circumstances where a wrongful act or omission of the Government is involved,[13] this is not deemed a case warranting equitable relief. Circumstances in which a Government contractor is delayed for reasons beyond its control, but not by reason of wrongful acts attributable to the other contracting party, are commonplace in Government procurement. Plaintiff's litigation on the legal grounds of breach of contract terminated in settlement of that action, as earlier described. This present application for equitable relief would, if favorably considered, set this plaintiff apart from any other Government contractors who have found themselves in similar circumstances. Payment of its losses as alleged would therefore constitute a gratuity.

For all of the foregoing reasons, it is concluded that plaintiff has neither an equitable nor legal claim against the United States for the losses it incurred in the performance of these contracts. Viewed from the standpoint of equity in a broad nonjuridical sense of that term, relief provided by the United States from those contract losses would be a gratuity.

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[12] *Burkhardt* v. *United States*, 113 Ct. Cl. 658, 666, 84 F. Supp. 553 (1949).

[13] *See & cf. Ghitescu* v. *United States*, 201 Ct. Cl. 823, 828 (1973); *Adler Constr. Co.* v. *United States*, 191 Ct. Cl. 607, 615, 423 F. 2d 1362, 1366 (1970), *cert. denied*, 400 U.S. 993 (1971); *Town of Kure Beach* v. *United States*, 168 Ct. Cl. 597 (1964); and *Rumley* v. *United States*, 169 Ct. Cl. 100, 108 (1965).

This determination is hereby submitted to the Chief Commissioner for transmittal to the United States Senate.

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## WILLIAMS PHILLIPS v. THE UNITED STATES

[Cong. Ref. No. 9-72. Filed October 6, 1975]

### REPORT TO THE UNITED STATES SENATE

**Congressional reference; injury to Government employee; claim for additional compensation.**—This congressional reference was referred to the Chief Commissioner of this court by S. Res. 368 (92d Cong., 2d Sess.) pursuant to 28 U.S.C. §§ 1492 and 2509. S. 1418 authorized the Secretary of the Treasury to pay claimant $5,000 in full satisfaction of all his claims for compensation for loss of sight in one eye, disfigurement and loss of earnings resulting from injuries he sustained on February 1, 1937 while working as a carpenter for the United States Army Corps of Engineers when his right eye was struck by a piece of wire. On February 3, 1937 claimant underwent surgery at an Army hospital; he remained hospitalized until February 26, by which time he was blind in the right eye. In 1939 his right eye was removed and replaced with an artificial one. The medical expenses for the two operations were borne by defendant; claimant was also paid all disability compensation due him under the provisions of the Act of September 7, 1916, 39 Stat. 742, as in force in 1937 and several years thereafter. Said Act limited compensation for partial disability resulting from a personal injury sustained while performing duty to 66⅔% of the difference between the employee's monthly pay at the time of the injury and his monthly wage-earning capacity after the beginning of such disability. Thus, unless an injury resulted in wage loss, no compensation could be paid. Payments to claimant ceased by 1943 or 1944. Claimant contends that under the 1949 amendments to the 1916 Act making the greater benefits thus provided retroactive to any case where the injury occurred after 1940, he is equitably entitled to additional compensation to make the payments to him equal the amounts he would have received had his injury occurred after 1940. A claim by one afforded all benefits due him under legislation in force in 1937 to the benefits of subsequently enacted legislation specifically made retroactive only to injuries occurring on and after January 1, 1940 cannot fairly be said to be an "equitable" one involving any obligations founded on considerations of good conscience or

**morality. The Senate is informed that claimant does not have a legal or an equitable claim and that any payment to him of compensation beyond that heretofore paid him would amount to a gratuity.**

**Congressional reference; equitable claim; what constitutes.**

[1] An equitable claim as used in 28 U.S.C. § 2509 is not used in a strict technical sense meaning a claim involving consideration of principles of right and justice as administered by courts of equity, but the broader moral sense based upon general equitable considerations. *Burkhardt* v. *United States*, 113 Ct. Cl. 658, 84 F. Supp. 553 (1949). The significance of this concept is that it permits going beyond the rules of law and applying "equity" in its broad sense. While the existence of an unjustified act or omission resulting in injury for which redress is sought is, on occasion, validly deemed a precondition to "equitable" liability under Sec. 2509, it is not a universally necessary one.

**Statutes; construction and operation; injury to Government employee; liberal construction.**

[2] A statute providing compensation for an injury to a federal employee is entitled to a liberal construction to effect its remedial purposes. Such a statute is, however, also a congressional declaration of what it considers its moral duty to one who has become disabled as a result of federal employment. Thus, where Congress in 1949 changed the law to provide that greater benefits should be paid for an injury to a federal employee occurring after January 1, 1940, in making the benefits retroactive to 1940 Congress did not create any equitable or moral rights in those persons outside the scope of the new provisions.

*Robert J. LeClair*, attorney of record, for plaintiff.

*Bernard M. Brodsky*, with whom was *Assistant Attorney General Rex E. Lee*, for defendant.

Before LYDON, *Presiding Commissioner of the Review Panel*, WHITE, *Senior Commissioner*, and MILLER, *Commissioner*.

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BY THE REVIEW PANEL: The United States Senate, by means of S. Res. 368 (92d Cong., 2d Sess., approved September 19, 1972), referred S. 1418 (92d Cong., 1st Sess.), a bill for the relief of William Phillips of Honolulu, Hawaii, to the Chief Commissioner of the United States Court of

Claims for proceedings in accordance with 28 U.S.C. §§ 1492 and 2509. S. Res. 368 mandated the furnishing of a report to the Senate by the Chief Commissioner "giving such findings of fact and conclusions thereon as shall be sufficient to inform the Congress of the nature and character of the demand as a claim, legal or equitable, against the United States, or a gratuity, and the amount, if any, legally or equitably due from the United States to the claimant."

S. 1418 authorized the Secretary of the Treasury to pay the claimant, William Phillips of Honolulu, Hawaii, the sum of $5,000 in full satisfaction of all his claims against the United States as compensation for loss of sight in one eye, disfigurement, and loss of earnings which resulted from injuries the claimant suffered on February 1, 1937, while employed by the United States Army Corps of Engineers.

Following proceedings considered appropriate by the attorneys representing the claimant and the United States, Trial Commissioner Harry E. Wood, pursuant to an assignment from the Chief Commissioner, filed his report on April 28, 1975, containing an opinion, findings of fact, and a conclusion. In his report, Trial Commissioner Wood "concluded that plaintiff [the claimant William Phillips] does not have a legal or an equitable claim, and that any payment to him of compensation beyond that heretofore paid to him would amount to a gratuity." Thereafter, the claimant, dissatisfied with the Trial Commissioner's report, filed exceptions thereto and a brief in support of his objections to the opinion, findings of fact and conclusion of the Trial Commissioner with the Review Panel designated by the Chief Commissioner. The United States filed a responding brief wherein it urged the Review Panel to adopt the Trial Commissioner's report as its own. Both the claimant and the United States waived oral argument before the Review Panel.

Upon careful consideration of the Trial Commissioner's report, claimant's exceptions and brief manifesting his objections thereto, defendant's brief in support of said report, and the complete record of the proceedings before the Trial Commissioner, since the Review Panel agrees with the opinion, findings of fact, and conclusion of the Trial Commissioner, it herein adopts the same as the basis for the report to the Senate as requested by S. Res. 368.*

Accordingly, the Senate is informed that claimant William Phillips of Honolulu, Hawaii, does not have a legal or an equitable claim against the United States relative to injuries he suffered on February 1, 1937, while employed by the United States Army Corps of Engineers, and that any payment to him of compensation beyond that already paid him because of said injuries would amount to a gratuity.

The opinion, findings of fact and conclusion of Trial Commissioner Harry E. Wood are attached hereto and incorporated herein.

## OPINION OF THE TRIAL COMMISSIONER **

WOOD, *Trial Commissioner:* By S. Res. 368, 92d Cong., 2d Sess., approved September 19, 1972, the United States Senate referred S. 1418, 92d Cong., 1st Sess., a bill for the relief of William Phillips, of Honolulu, Hawaii, to the Chief Commissioner pursuant to 28 U.S.C. §§ 1492 and 2509 (1970). S. 1418 authorizes and directs the Secretary of the Treasury to pay to plaintiff the sum of $5,000 "in full satisfaction of all his claims against the United States for compensation for loss of sight in one eye, disfigurement, and loss of earnings which resulted from injuries suffered by the said William Phillips on February 1, 1937, while employed by the United States Army Corps of Engineers."

The facts out of which the claim herein arises are relatively simple, and essentially undisputed. On February 1, 1937, while an employee of the District Engineer, United States Army Corps of Engineers, and at work at Alaimanu Crater, Honolulu, Hawaii, as a carpenter, Mr. Phillips sustained personal injury while in the performance of his duty.

More specifically, while Mr. Phillips was in the process of building a wooden form for concrete to be poured, the end of a piece of wire used to tie steel reinforcing rods together struck his right eye. He was treated as an outpatient on

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*Whereas the Review Panel adopts the trial commissioner's separate findings of fact, they are not printed in this volume of the Court of Claims Reports, since such facts as are necessary are contained in his opinion.

**The opinion, findings of fact, and conclusions are submittted pursuant to the Rules of the Chief Commissioner.

February 1, 1937, and then hospitalized from February 2 to February 26, 1937, at Tripler General Hospital, Honolulu. When he was discharged from the said hospital February 26, 1937, he was blind in the right eye. Some 2 years later, the eye, which by then had shrunk, was surgically removed and replaced with an artificial one.

In essence, the act of September 7, 1916, 39 Stat. 742, 5 U.S.C. §§ 751 *et seq.* (1940), as in force in 1937 and for many years thereafter, limited the disability compensation due a government employee for partial disability resulting from a personal injury sustained while in the performance of his duty to "66⅔ per centum of the difference between his monthly pay [at the time of the injury] and his monthly wage-earning capacity after the beginning of such partial disability." Thus, unless an injury resulted in wage loss, no compensation could be paid. The 1916 act did provide, however, that defendant would furnish an injured employee the necessary medical, surgical and hospital service.

The 1916 act authorized neither a schedule award for an injury causing loss of an eye, nor compensation for disfigurement. Plaintiff's medical expenses arising from both the February 1, 1937 injury and the 1939 removal of his eye (and its replacement with an artificial one) were borne by defendant. Plaintiff was also paid all disability compensation due him under the provisions of the 1916 law as in force in and after 1937. Since, however, wage loss (measured against monthly pay at the time of injury) was a prerequisite to entitlement to disability compensation in and after 1937, payments to plaintiff ceased by 1943 or 1944. While plaintiff could not testify to the exact amount of compensation he was paid, the Department of the Army reported to the Senate in 1970 that, according to the Department of Labor, the total amount thereof was $881.80.

Plaintiff readily concedes that he has no legal claim to relief. And, on analysis of just what plaintiff seeks in this reference, it is readily apparent that he does not have a "legal or equitable claim against the United States, in the sense of a claim enforceable in a court, under applicable legal standards." *Rumley* v. *United States*, 169 Ct. Cl. 100, 103 (1965).

See also *Palmer-Bee Co.* v. *United States*, 142 Ct. Cl. 485, 488 (1958).

Indeed, plaintiff does not even suggest he was deprived of any benefits due him under the act of September 7, 1916, *supra*, as it stood in 1937 and for some years thereafter. The essence of the claim is, rather, that in 1949 Congress amended the 1916 act to confer greater benefits than had theretofore been provided, that the 1949 amendments were made retroactive to any case where the injury occurred on or after January 1, 1940, and that he is "equitably" entitled to be paid sufficient additional compensation to make the payments to him for his injury equal that he would have received had his injury occurred after, rather than before, January 1, 1940.

In *Burkhardt* v. *United States*, 113 Ct. Cl. 658, 667, 84 F. Supp. 553, 559 (1949), the court expressed the "opinion that the term 'equitable claim' as used in 28 U.S.C., Sec. 2509, is not used in a strict technical sense meaning a claim involving consideration of principles of right and justice as administered by courts of equity, but the broader moral sense based upon general equitable considerations." The very significance of the concept thus described is that it permits going beyond the rules of law, and applying "equity" in its broad sense. *Rumley* v. *United States*, *supra*, 169 Ct. Cl. at 106. See also *Ghitescu* v. *United States*, 201 Ct. Cl. 823, 827–28 (1973), and cases there cited; *Town of Kure Beach* v. *United States*, 168 Ct. Cl. 597 (1964); *Georgia Kaolin Co.* v. *United States*, 145 Ct. Cl. 39 (1959).

While the existence of an "unjustified act or omission resulting in the injury for which redress is sought" is, on occasion, validly deemed a precondition to "equitable" liability under Section 2509, it is, plainly and assuredly, not a universally necessary one. *Ghitescu* v. *United States*, *supra; Rumley* v. *United States*, *supra; Town of Kure Beach* v. *United States*, *supra; cf. Burt* v. *United States*, 199 Ct. Cl. 897 (1972). As the cited authorities establish, the concept embodied in Section 2509 is not so narrowly limited here.

Even viewed in the light of the broadest moral principles of right and justice, however, a claim by one afforded all benefits due him under legislation in force in 1937, when his loss of sight in the right eye occurred, to the benefits of subsequently enacted legislation specifically made retroactive only to injuries occurring on and after January 1, 1940, cannot fairly be said to be an "equitable" one involving any obligation founded on considerations of good conscience or morality.

A statute which provides compensation for an injury to a federal employee is entitled to a liberal construction to effect its remedial purposes. *Cf. United States* v. *Zacks*, 375 U.S. 59, 68 (1963). Such a statute is, however, also a congressional declaration of what it considers its moral duty to one who has become disabled as a result of his federal employment. See *Mackie* v. *United States*, 172 Ct. Cl. 393, 396 (1965); *Stone* v. *United States*, 160 Ct. Cl. 128 (1963). The benefits accruing to plaintiff pursuant to the laws in effect at the time he was injured are the extent of the obligation Congress thought it owed to one so disabled in consequence of his federal civilian employment. *Cf. Hayfield* v. *United States*, 155 Ct. Cl. 589 (1961).

When, in 1949, Congress changed the law to provide that greater benefits should be paid for such an injury occurring after January 1, 1940, it could easily have made the change applicable to those injured prior to January 1, 1940, as well. It specifically declined to do so, however. That question was one for determination by the Congress as a matter of policy. *Mackie* v. *United States, supra; Stone* v. *United States, supra.* It cannot be said that in making the decision it did, Congress created any equitable or moral rights in those persons, like plaintiff, outside the scope of the new statutory provisions as enacted. *Cf. Abrams* v. *United States*, 159 Ct. Cl. 388, 397–98, 311 F.2d 230, 234–35 (1963); *Hayfield* v. *United States, supra; Olney* v. *United States*, 123 Ct. Cl. 285, 105 F. Supp. 1005, *cert denied*, 344 U.S. 898 (1952).

To give plaintiff greater compensation for his injury than others similarly situated would be to give him "preferential treatment, which is abhorrent to our sense of justice." *Mackie* v. *United States, supra.* Any decision by the Congress to do so would be a matter of legislative grace, not the satisfaction of any "equitable" obligation. *Ibid;* see also *Stone* v. *United States, supra.*

In these circumstances, any conclusions respecting the defenses of limitations and laches, both asserted by defendant herein, are deemed unnecessary. It is, however, perhaps appropriate to note that since the claim rests entirely on an asserted moral obligation, the applicability of the doctrine of limitations is less than crystal clear. Too, it should perhaps be observed that the absence of prejudice to defendant from the timing of the claim renders the efficacy of the defense of laches questionable. *Cf. McQuown* v. *United States*, 199 Ct. Cl. 858 (1972). In view of the result here reached, however, both issues may be, and are, pretermitted.

In sum, it is concluded that plaintiff does not have a legal or an equitable claim, and that any payment to him of compensation beyond that heretofore paid to him would amount to a gratuity.

## ALASKA NATIVE CLAIMS SETTLEMENT ACT

**[The following reports were filed In Re Attorney Claims and Native Association Claims pursuant to Section 20 of the Alaska Native Claims Settlement Act, Pub. L. 92-203, 85 Stat. 688].**

### Attorney Claims

On March 10, 1975, Trial Commissioner Wood, pursuant to Sec. 20(d)(9), Alaska Native Claims Settlement Act, 85 Stat. 688, submitted to the Review Panel his findings of fact and conclusions on all pending Sec. 20(b) attorney claims for fees for services rendered. On April 28, 1975, Trial Commissioner Wood filed supplemental findings of fact and conclusions in response to the Review Panel's opinion filed April 15, 1975. The opinion of the Review Panel filed April 15, 1975 and the Review Panel's supplemental opinion filed May 1, 1975 follow:

### Review Panel's Opinion

**[April 15, 1975]**

The review panel adopts the trial commissioner's opinion, findings of fact and conclusions, filed March 10, 1975, with the additional views which follow:

1. The Department of Justice and the trial commissioner each have concluded that the value of the attorneys' claims for services rendered, in the aggregate, is at least $1,900,000. The Department of Justice states that it has no interest in how the sums involved are distributed among the various claimants.

2. Payment of attorney fee claims is authorized by the Act only for services rendered. Both the statute and good procedure require that the individual claims, as well as the aggregate of all claims, be supported by determinations that the respective amounts to be paid are commensurate with the services rendered. This is particularly appropriate where the amounts to be allowed for individual claims for at-

torneys' fees have been reached by mutual agreement without trial or independent analysis of the merits of each claim by the trial commissioner.

3. The trial commissioner has not made a specific finding of fact that the value of the services rendered by each claimant is at least the amount stipulated to be allowed for each respective claim. He states:

> While there are in many claims grave questions as to components thereof, and some few claims are of doubtful validity in substantial part, or more, it is clear that when Section 20 is viewed as a whole, such questions do not obscure either the magnitude of those tasks performed by attorney (and consultant) claimants which are plainly and properly within the ambit of either Section 20(b)(1) or Section 20(b)(2), or the impressive results achieved by the Alaska Natives represented by the attorney (and consultant) claimants by legislative settlement of Native land claims.

The trial Commissioner concludes, however, that:

> [A]llowance of each pending claim for attorneys' fees for services rendered, in accordance with the stipulation agreed to by all such claimants, is just and proper. Accordingly, and in accordance with that stipulation, the name and address of each claimant, as the claimant's name appears on the claim submitted to the Chief Commissioner, and the amount to be allowed * * * to that claimant in full satisfaction of that claimant's claim (or claims, where appropriate) as it (or they) relates (or relate) to services rendered are * * *.

4. In the light of the adversary positions of the respective claimants with respect to the limited fund available, and on the basis of the certifications in the stipulation itself, the affidavits of disinterested persons that have been filed in support of the claims, the absence of opposition by persons who would otherwise be entitled to the funds as a part of the Alaska Native Fund, and, particularly, the affidavits of the claimants filed concurrently with the stipulation, the review panel concludes and finds that, with the two exceptions hereafter noted, each of the individual claimants has rendered services at least in the value of the amounts to be paid pursuant to the stipulation.

5. Notwithstanding the provision in the stipulation that it was to be supported by concurrent affidavits, no affidavit has been filed by the claimants in F–4 and F–11. Although the other considerations support a conclusion that the amounts of the claims are justified, particularly in view of the limited amounts involved, payment should not be made on F–4 and F–11 until the required affidavits have been filed and found adequate by the trial commissioner.

6. As expressly noted by the trial commissioner in his opinion of March 10, 1975, and by counsel in their settlement stipulation of December 26, 1974, the subject settlement touches only fee claims, leaving claims for reimbursement of out-of-pocket expenses incurred by attorneys for determination in a separate and subsequent proceeding.

In his pretrial opinion of October 26, 1973 (pp. 19–20), the trial commissioner held that the allowance of out-of-pocket expenses was not subject to the fund limitations of 43 U.S.C. § 1619(d)(4) and the review panel affirmed that holding in its opinion of May 3, 1974 (pp. 5–9).

Title 43 U.S.C. § 1619(d)(3) directs in part that: "The amount allowed for out-of-pocket expenses shall * * * be limited to expenses that were * * * unreimbursed * * *." The attorneys' settlement stipulation states in part (p. 10): "Each claimant certifies that they have not received, *or made application for* any other remuneration for the time and services claimed in these proceedings." (Emphasis added.)

It is presumably undisputed that the fee and expense[1] categories are mutually exclusive for claim and allowance purposes. Accordingly, the deferral of consideration of attorney expense claims until after the compromise disposition of the fee matter presents no problem provided that it is understood that no item will be eligible for allowance as an expense if it was within the scope of the fee claim compromised by the attorney involved, the principle being that the compromise is deemed to constitute reimbursement, within the meaning of 43 U.S.C. § 1619(d)(3), for all facets of the claim to which the compromise relates. In any event, no item of expense will be eligible for reimbursement except as it is included in a claim for expense in the amounts tabulated on pages 3 and 4 of the trial commissioner's opinion.

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[1] In his opinion of March 10, 1975, the trial commissioner has tabulated all pending claims for expenses by attorneys. Those claims total $182,584.52 [a so-called "alternative" claim in Docket No. F–15, in the amount of $22,334.70, has been excluded for purposes of defining the Natives' maximum exposure for attorneys' expenses because that is an amount, according to the claimants' own knowledgment (Pet., p. 692), that has already been reimbursed].

### REVIEW PANEL'S SUPPLEMENTAL OPINION

[May 1, 1975]

The review panel adopts the trial commissioner's supplemental opinion, findings of fact, and conclusion, filed April 28, 1975, with the addition that follows:

The trial commissioner's supplemental opinion does not make specific findings of fact that the value of the services rendered by claimants F–4 and F–11 is at least the amount stipulated to be allowed for each respective claim.

The review panel has examined the affidavits filed by claimant F–4 on April 21, 1975, and by claimant F–11 on April 25, 1975. In the light of the adversary positions of the respective claimants with respect to the limited fund available, and on the basis of the certification in the stipulation itself, the affidavits of disinterested persons that have been filed in support of the claims, the absence of opposition by persons who would otherwise be entitled to the funds as a part of the Alaska Native Fund, and, particularly, the affidavits of the claimants, the review panel concludes and finds that claimant F–4 and claimant F–11 have rendered services at least in the value of the amounts to be paid them pursuant to the stipulation.

## NATIVE ASSOCIATION CLAIMS

On July 10, 1975, Trial Commissioner Wood, pursuant to Section 20 of the Alaska Native Claims Settlement Act, submitted to the Review Panel his opinions, findings of fact and conclusions respecting Alaska Native Association claims identified N–2, N–3, N–4, N–5, N–6, and N–7. On October 23, 1975 the Review Panel filed an opinion as follows:

## REVIEW PANEL'S OPINION

[October 23, 1975]

BY THE REVIEW PANEL: These proceedings involve claims under section 20(g) of the Alaska Native Claims Settlement Act (43 U.S.C. § 1619(g)). Insofar as pertinent that section provides:

> A claim for actual costs incurred in filing protests, preserving land claims, advancing land claims settlement legislation, and presenting testimony to the Congress on proposed Native land claims may be submitted to the Chief Commissioner of the Court of Claims by any bona fide association of Natives. * * * The Chief Commissioner shall allow such amounts as he determines are reasonable, but he shall allow no amount for attorney and consultant fees and expenses which shall be compensable solely under subsection (b) through (e) of this section. If approved claims under this subsection aggregate more than $600,000, each claim shall be reduced on a pro rata basis. The Chief Commissioner shall certify to the Secretary of the Treasury, and report to the Congress, the amount of each claim allowed and the name and address of the claimant. The Secretary of the Treasury shall pay to such claimant from the Alaska Native Fund the amount certified. * * *

In separate opinions, findings and conclusions filed July 10, 1975, the trial commissioner recommended payment of the following approved allowances with respect to the claimants and claims set forth below:

| *Claimants* | *Amounts Claimed* | *Amounts Approved* | *Reduced Pro Rata to Approved Allowances* |
|---|---|---|---|
| Alaska Federation of Natives, Inc., No. N-2 | $753, 877. 00 | $513, 255. 00 | $446, 692. 85 |
| Cook Inlet Native Association, Inc., N-3 | 14, 312. 40 | 9, 846. 23 | 8, 569. 31 |
| Central Council of the Tlingit and Haida Indians of Alaska, No. N-4 | 103, 318. 90 | 84, 141. 23 | 73, 229. 26 |
| Alaska Federation of Natives, Washington Chapter, No. N-5 | 4, 951. 71 | 2, 831. 00 | 2, 463. 86 |
| Arctic Slope Native Association, No. N-6 | 241, 240. 11 | 75, 733. 14 | 65, 911. 59 |
| Arctic Native Brotherhood, No. N-7 | 5, 510. 40 | 3, 600. 00 | 3, 133. 13 |
| Total | $1, 123, 210. 52 | $689, 406. 60 | $600, 000. 00 |

While many of the findings with respect to allowability of components of the claims are supported by subsidiary findings, it is also apparent that many others are intuitive estimates or judgments peculiarly within the discretion or insight of the trial commissioner without reference to probative facts capable of supporting them. These are described throughout the findings as determinations "by way of a jury verdict" and from "consideration of the record as a whole." Explanatory of this approach is the following prefatory language from page 14 of the trial commissioner's findings of fact in *Alaska Federation of Natives, Inc.*, No. N–2:

> * * * the available evidence is so general and imprecise as to make precise determinations of purpose and reasonableness and assure mathematical calculations of the allowable portion of many, if not most, categories of costs claimed herein impossible. Accordingly, where the proof herein so necessitates, the only feasible answer is resort to a jury verdict, after consideration of the record (including Mr. Howard's workpapers) as a whole, and that technique must be, and will be, frequently employed herein.

Another exemplar of such approach is the statement which appears in substantially similar form in findings with respect to several of the claimants incident to granting allowances based on "consideration of the record as a whole." It states:

> * * * In determining whether, and to what extent, claimant has established that the [expenditures] it actually incurred * * * were both reasonable and within the purview of Section 20(g), a check-by-check (or item-by-item) allowance or disallowance (in whole or in part) would be neither fair nor, on this record, really feasible.

*Alaska Federation of Natives, Washington Chapter*, No. N–5, page 11; and *see also Central Council of the Tlingit and Haida Indians*, No. N–4, page 19 and *Arctic Native Brotherhood*, No. N–7, page 8.

The review panel's function is defined by section 20(d)(9) of the statute (43 U.S.C. § 1619(d)(9), which provides:

> The findings and conclusions of the trial commissioner shall be submitted by him, together with the rec-

> ord in the case, to the review panel of commissioners for review by it pursuant to such rules as may be provided for the purpose, which shall include provision for submitting the decision of the trial commissioner to the claimant and any party contesting the claim for consideration, exception, and argument before the panel. The panel, by majority vote, shall adopt or modify the findings or the conclusions of the trial commissioner.

Findings of fact said to be derived solely from "consideration of the record as a whole" are insufficient to provide a basis for judicial review. They must be supported by identified probative facts sufficient to enable a reviewing authority to understand clearly the evidentiary basis for the finding. *In re Leichter*, 197 F.2d 955, 957 (3d Cir. 1952), *cert. denied*, 344 U.S. 914 (1953); *Alexander* v. *Nash-Kelvinator Corp.*, 261 F.2d 187, 191 (2d Cir. 1958); *Neill* v. *Diamond M. Drilling Co.*, 426 F.2d 487, 492 (5th Cir. 1970); and *see also Old Colony Bondholders* v. *New York, N.H. & H.R. Co.*, 161 F.2d 413, 449–51 (2d Cir.) (opinion of Frank, J. dissenting in part) *cert. denied*, 331 U.S. 859 (1947).

Although many of the trial commissioner's findings of fact do not meet minimal requirements for review, the record does not indicate that they are necessarily wrong. Contrast Review Panel's Order and Opinion of August 1, 1975, *In Re Consultant Claims*, where the record showed apparent deficiencies. In these circumstances a remand for more complete findings is not essential because the validity of the ultimate conclusions that proceed from those findings is otherwise sufficiently reinforced. The court's own auditors have satisfied themselves that the costs in question were actually incurred by the claimants. The competing claimants, who have a stake in the proper disposition of the fund from which the payments are to be made because all of their allowances have been reduced by the trial commissioner on a pro rata basis, have indicated by their failure to seek review of the trial commissioner's findings and determinations that they are satisfied that the ultimate allowances are due the claimants.[1]

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[1] In some claims, costs incurred between December 14, 1971, and December 18, 1971, may have been disallowed improperly. (*Alaska Federation of Natives, Inc.*, N–2, findings 25(c) at 30, 27 at 31, 52(b) and (c) at 42–43; *Central Council of the Tlingit and Haida Indians of Alaska*, N–4, findings 8(c) at 13, 12(a) and (c) at 15, 15 at 18, 17(a) at 19, and 21 at 22; *Arctic Slope*

Moreover, on August 26, 1975, the review panel ordered that the trial commissioner's opinions, findings and conclusions in these cases be served upon each of the Regional Corporations entitled under the Act to all money in the Alaska Native Fund not paid out for fees, expenses and costs pursuant to section 20. (*See* section 6(c) of the Act (43 U.S.C. § 1605 (c).) Such corporations were afforded 30 days within which to file any objections that they might have to the proposed disbursements. That period has now expired and none of the corporations has filed any objections or other comments. Accordingly, the review panel adopts the conclusions of the trial commissioner as to the amounts to be paid to the claimants.

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*Native Association*, N–6, finding 30(b) at 23.) The Trial Commissioner's May 2, 1973 *Order Re Audit* instructed the auditors that certain costs incurred after December 14, 1971, need not be audited and that the audit reports should note exceptions to claims therefor. The erroneous interpretation as to the proper cutoff date for claims, and as to the effective date of the Act, was corrected by the review panel in its May 3, 1974 Opinion and Order that reviewed the trial commissioner's pretrial procedures in the claims for attorney and consultant fees. Inasmuch as no Native Association has sought review of the trial commissioner's disallowance in his July 10, 1975 opinions of certain post-December 14, 1971 cost items, any objection as to error in such disallowances has been waived.

# ORDERS

**No. 308–74. May 2 and May 30, 1975**

Naum S. Bers

*Implied contract; authority of Government representative; public employment; tort claim.*—On May 2, 1975 the court issued the following order:

Before Cowen, *Chief Judge*, Davis and Kashiwa, *Judges.*

"This case comes before the court on defendant's motion for summary judgment and plaintiff's opposition thereto. Upon consideration thereof, the court finds that plaintiff seeks recovery on his first (fourth) cause of action on the ground that an implied contract was entered into between plaintiff and representatives of the Department of Health, Education, and Welfare, resulting from a promise by defendant's representative that if plaintiff's material relating to the 'Professional Standards Review Organization' was furnished to and was found acceptable by defendant, plaintiff would be granted a position in the agency. Accepting plaintiff's allegations as true, the court concludes that the pleading fails to set forth facts sufficient to establish a contract implied in fact because:

"(1) There is no allegation that the Government employee with whom plaintiff met had any authority to enter into the alleged contractual agreement;

"(2) defendant's unchallenged affidavit shows that such authority did not exist, and

"(3) even if the Government's representative had the requisite authority, no meeting of the minds could be inferred, because the alleged agreement was conditioned on the acceptability of plaintiff's work. *See Algonac Mfg. Co.* v. *United States*, 192 Ct. Cl. 649, 428 F.2d 1241 (1970); *Putnam Mills Corp.*, 202 Ct. Cl. 1, 479 F.2d 1334 (1973), and *Colonial*

*Metals Co.* v. *United States*, 204 Ct. Cl. 320, 494 F.2d 1355 (1974).

"The court also finds that plaintiff's remaining cause of action, the second cause of action, seeks exemplary or punitive damages based upon the alleged 'willful, wanton, violent, and maliciously done' acts of the Government. The court concludes that this claim clearly sounds in tort and is outside our jurisdiction. *Somali Development Bank* v. *United States*, 205 Ct. Cl. 741, 508 F.2d 817 (1974); *Vincin* v. *United States*, 199 Ct. Cl. 762, 765, 468 F.2d 930, 932 (1972).

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted and plaintiff's petition is hereby dismissed."

In response to plaintiff's motion to reconsider and review, on May 30, 1975 the court issued an order reading in part as follows:

"We find nothing in plaintiff's motion for reconsideration which would justify the court in setting aside the order [of May 2, 1975] which granted defendant's motion for summary judgment. It is clear that plaintiff's only cause of action within the jurisdiction of the court (first cause of action) rests on the allegation that defendant's representative advised plaintiff that positions in the agency were available and that if plaintiff's work was acceptable to Dr. Roberts, plaintiff would be granted one of these positions. Plaintiff has neither alleged nor otherwise shown that he was actually appointed to a Federal position by an official authorized under the regulations to make such an appointment. This failure mandates the dismissal of his claim. See *Price* v. *United States*, 65 Ct. Cl. 91, 95, *cert. denied*, 277 U.S. 587 (1928). Furthermore, plaintiff's total reliance on the theories of contract law is misplaced, since 'public employment does not * * * give rise to a contractual relationship in the conventional sense.' *Urbina* v. *United States*, 192 Ct. Cl. 875, 881, 428 F. 2d 1280, 1284 (1970), *see Crenshaw* v. *United States*, 134 U.S. 99 (1890); *Borak* v. *United States*, 110 Ct. Cl. 236, 78 F. Supp. 123, *cert. denied*, 335 U.S. 821 (1948).

"IT IS THEREFORE ORDERED that plaintiff's 'motion to reconsider' be and the same is denied."

On June 18, 1975, plaintiff filed a motion to reconsider and review; on October 3, 1975 the court denied the motion. On October 30, 1975 the court denied plaintiff's request for explanation of the order of October 3, 1975.

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No. 186-74. MAY 1, 1975

Catherine J. Gabay

*Civilian pay; dismissal.*—Plaintiff, a former employee of the Post Office Department, was removed from her position based on charges that she submitted falsified medical certificates for sick leave upon which physicians' signatures had been forged. Having exhausted her administrative remedies, plaintiff here seeks reinstatement and back pay. On May 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

"This case comes before the court on defendant's motion for summary judgment. Upon consideration thereof, since the Civil Service Commission Board of Appeals and Review decision affirming plaintiff's removal was not arbitrary or capricious but was in fact based on substantial evidence, *Powers* v. *United States*, 169 Ct. Cl. 626 (1965); *Harrington* v. *United States*, 174 Ct. Cl. 1110 (1966); *Polcover* v. *Secretary of the Treasury*, 477 F. 2d 1223 (D.C. Cir. 1973), *cert. denied*, 414 U.S. 1001; and, also, since plaintiff suffered no procedural violations at any stage of the removal proceedings, *Terry* v. *United States*, 204 Ct. Cl. 543, 555–56, 499 F. 2d 695, 701 (1974), *cert. denied*, 421 U.S. 912 (1975).

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted and plaintiff's petition is dismissed."

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No. 237-74. MAY 2, 1975

Loew's Theatres, Inc., as successor to Federal Tin and Paper Products, Inc.

*Taxes; suit for refund; limitation on filing of claim.*—On May 2, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

"This tax refund case comes before the court on defendant's motion for summary judgment, which contends that the court lacks jurisdiction over plaintiff's claim because the petition for refund was not filed in timely fashion in this court. Upon consideration of defendant's motion and plaintiff's opposition, the court finds:

"(1) Plaintiff, a New York corporation, was engaged during the period in question in various business activities, many of which stemmed from its merger in 1969 with P. Lorillard Company. Plaintiff's claim before this court concerns certain taxes assessed and collected by defendant from Federal Tin and Paper Products, Inc. (formerly Federal Tin Company), at one time a wholly-owned subsidiary of P. Lorillard Company.

"(2) On April 27, 1971, defendant sent by certified mail two Notices of Claim Disallowance, Form RSC–105 (Rev. 5–70) to plaintiff. These notices were addressed to 'Loew's Theatres,' and included reference to the proper tax year, the correct type of tax, and the exact amount of refund sought. Letters with certification numbers identical to the two notices were received in plaintiff's mailroom on or about April 29, 1971. Instead of being transmitted to plaintiff's tax department for proper handling, these communications were sent unopened to a secretary in plaintiff's legal department, where they were either lost or misplaced. Plaintiff did not file its claim in this court until July 1, 1974, more than three years after the Notices of Claim Disallowance were properly transmitted to plaintiff.

"(3) Section 6532(a)(1) of the Internal Revenue Code clearly states that '[n]o suit or proceeding . . . for the recovery of any internal revenue tax . . . shall be begun . . . after the expiration of 2 years from the date of mailing . . . to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates.' The two Notices of Claim Disallowance gave adequate notice to plaintiff, so that the two-year limitations period properly commenced on April 27, 1971. *See Smith* v. *United States*, 478 F. 2d 398, 399 (5th Cir. 1973). The delay in filing the claim resulted from internal mishandling by plaintiff. Since plaintiff's claim was not filed within the period of time allowed by section 6532(a)(1), the court does not have jurisdiction over this matter.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted and that plaintiff's petition be and the same is hereby dismissed."

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No. 445–74. MAY 2, 1975

Frank J. and Nancy M. Bondanza

*Taxes; claim for refund; limitation on filing claim.*—On May 2, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges*.

"This case comes before the court on defendant's motion to dismiss plaintiffs' petition for the recovery of income taxes on the ground that plaintiffs failed to file a timely claim for refund.

"Upon consideration thereof, the court finds that on April 4, 1974, plaintiffs filed a claim for refund of income taxes for the tax year ending December 31, 1969. Under the provisions of the Internal Revenue Code, 26 U.S.C. §§ 7422 and 6511, plaintiffs' deadline for filing the claim for refund was April 15, 1973. Since the claim for refund was not filed within the time required by law, the court concludes that it has no jurisdiction of this case, and plaintiffs' petition is hereby dismissed."

Plaintiffs' motion for reconsideration, motion for rehearing, and motion for new trial and other relief were denied by the court on October 3, 1975, November 26, 1975 and January 30, 1976, respectively.

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No. 316–69. MAY 9, 1975

Everett C. Young

On May 9, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, NICHOLS and BENNETT, *Judges*.

"This case comes before the court on plaintiff's motion, filed February 27, 1975, 'under Rule 152 citing the U.S. Court of Claims for fraud' and for leave to file under Rule 152 by submitting one original and three copies because plaintiff asserts that he is a pauper. Plaintiff's motion requests that it be examined by Judges in the court other than the panel which dismissed plaintiff's petition by order of April 24, 1974, 204 Ct. Cl. 867, (which affirmed and adopted the recommended decision of Trial Judge Joseph V. Colaianni as the basis for its judgment) and has denied plaintiff's various motions for rehearing, reconsideration and relief from judgment, and the motion has therefore been deemed as having been filed as a suggestion for reconsideration *en banc* pursuant to Rule 7(d).

"The case has been considered by the seven active Judges of the court as to plaintiff's suggestion for reconsideration *en banc*, which suggestion is denied. In this consideration the court finds that statements of plaintiff in the motion of February 27, 1975, are abusive, scurrilous, unfounded and unwarranted and that any belief or information received by the plaintiff or others to the effect that the recommended decision and opinion filed by Trial Judge Joseph V. Colaianni in this case was not formulated or written by him or that the case has not been decided solely upon the evidence presented to the trial judge and the court is completely without foundation.

"The case having been further considered, without oral argument, by the panel listed above, as to the aspects of the plaintiff's motion of February 27, 1975, set forth as having been filed under Rule 152,

"IT IS ORDERED that plaintiff's said motion be and the same is denied."

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NO. 300-70. MAY 9, 1975

Gay Gibson, Inc.

*Taxes; income tax; deductions; trade or business expenses; compensation or salaries for services; reasonable compensation.*—On May 9, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on the exceptions of the parties to the opinion and findings filed September 30, 1974, by Trial Judge Willi [reported in full text at 1974 P–H Fed. Tax. para. 58036 and 1974 CCH Stand. Fed. Tax Rep. para. 7916] who held in plaintiff's favor on part of its claim. The issue in the case is the deductibility for federal tax purposes of various amounts paid to three company officers during fiscal years ended September 30, 1962, 1963, and 1964. The Commissioner of Internal Revenue disallowed claimed deductions to the extent that they exceeded lower figures arrived at by him in reviewing plaintiff's returns which claimed salary deductions as ordinary and necessary expenses under Sec. 162(a)(1) of the Internal Revenue Code of 1954. The trial judge found and concluded that for each of the years in suit not more than $60,000 paid to Paul Willson, $12,000 paid to Sara DeSaix Gernes, and $6,000 paid to Milton Gordon represented compensation, reasonable in amount, for services actually rendered plaintiff.

"Upon consideration of the findings and opinion of the trial judge, the briefs and exceptions of the parties, and upon oral argument, the court is satisfied that the trial judge's findings and opinion, copies of which have heretofore been furnished to the parties, are correct with the exception that in finding No. 15 the figure for total assets for fiscal year 1963 should be $3,271,223 and for fiscal year 1964 should be $3,837,664, and they are hereby corrected to so reflect.

"IT IS THEREFORE ORDERED that the court hereby adopts the findings and opinion of the trial judge, as modified above, as the basis for its judgment in the case. Entry of final judgment is deferred until the amount of recovery has been determined in further proceedings under Rule 131, for which proceedings the case is remanded to the trial judge."

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In accordance with the foregoing order of the court, a memorandum report of the trial judge, and a stipulation of the parties, on November 14, 1975 the court entered judgment for plaintiff as follows:

| *Year* | *Tax and Assessed Interest* |
|---|---|
| FYE 9/30/62 | $9,977.93 |
| FYE 9/30/63 | 8,963.12 |
| FYE 9/30/64 | 9,610.57 |

The court also ordered that plaintiff be allowed interest as provided by law on the above amounts, such interest to run from October 9, 1967 on all tax and assessed interest balances for fiscal years 1962 and 1963 and from October 29, 1967 on the balance of tax and assessed interest for fiscal year 1964.

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NO. 192–73. MAY 9, 1975

Donald H. Wood

*Civilian pay; classification action.*—On May 9, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on cross-motions for summary judgment. Plaintiff demands lost wages resulting from his separation from Government service following a reduction-in-force in which his position was abolished. Plaintiff contends that he had a right to retention which was denied to him by unjustified personnel action. He claims that the competitive level to which he was assigned was not properly defined in accordance with applicable law and regulation, and that his agency, the Defense Intelligence Agency, Department of Defense, abused its discretion in defining the positions for which plaintiff was qualified during his employment and in the pertinent period thereafter. Plaintiff contested his separation and has exhausted his administrative remedies, unsuccessfully, before the Appeals Examining Office, Civil Service Commission, and before the CSC Board of Appeals and Review.

"Plaintiff agrees that our review is limited to the questions of whether there has been substantial compliance with procedural requirements and whether the administrative action is so lacking in rational support as to be arbitrary, capricious, so grossly erroneous as to imply bad faith, or is not supported by substantial evidence. Plaintiff concedes that the administrative decisions are entitled to a presumption of correctness and that he has the burden of proof to show that they are not correct. Plaintiff has well briefed and argued his contentions that his competitive level was not defined in accordance with applicable Civil Service Commission regulations and failed to give effect to the congressional intent to preserve the right of employees to retention, and that his agency abused the discretion allowed to it in defining positions during periods pertinent to plaintiff's employment. The court has carefully considered plaintiff's contentions but is not persuaded of their correctness. We find no violation of applicable law or regulations, no lack of substantial evidence as to the correctness of the adverse administrative decision by the Civil Service Commission, and no arbitrary, capricious or grossly erroneous action or bad faith which would vitiate that decision which we believe is entitled to finality under the circumstances of this case; nor do we find any material facts requiring a trial. We do not find it necessary to reach defendant's defense of mootness wherein defendant argues that plaintiff would have lost his job due to reduction-in-force even if the competitive level codes had been combined and his position and others had been assigned to the same level, as plaintiff urges.

"IT IS THEREFORE ORDERED, upon consideration of the briefs, exceptions, and oral argument of the parties, and upon the authority of 5 U.S.C. § 5105, *et seq.*, *Garrigan* v. *United States*, 206 Ct. Cl. 894 (1975), *Wilmot* v. *United States*, 205 Ct. Cl. 666 (1974), *DiRocco* v. *United States*, 201 Ct. Cl. 867 (1973), and *Bookman* v. *United States*, 197 Ct. Cl. 108, 116, 453 F. 2d 1263, 1267 (1972), that defendant's motion for summary judgment be and it is allowed, plaintiff's cross-motion for summary judgment is denied, and the petition is dismissed."

Plaintiff's motion for rehearing was denied on June 27, 1975. Plaintiff's petition for certiorari was denied December 1, 1975, 423 U.S. 994.

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No. 33-73. MAY 30, 1975

LTC James A. Dennis

*Military pay; retirement for length of service; claim of physical unfitness.*—Plaintiff, an Army Reserve Commissioned Officer, was retired on March 31, 1960, at the age of 39, under 10 U.S.C. § 3911 on the basis of length of service in the grade of Lieutenant Colonel, at which time he was determined to be physically fit for duty. In this suit, he contends that on the date of his retirement he was physically unfit for duty by reason of a permanent disability (stemming from a nervous condition and related symptoms) and therefore eligible for disability retirement. Plaintiff alleges that subsequent denials by the Army Board for Correction of Military Records of his application for correction of his records to show retirement by reason of physical disability, rather than longevity, was arbitrary and capricious and constituted substantial error; he consequently seeks a judgment herein directing that his military records be corrected to show retirement for disability together with all monetary benefits that flow from such a determination. In a recommended decision filed October 1, 1974 Trial Judge Thomas J. Lydon concluded (1), on the basis of the totality of the record, that plaintiff was physically and mentally fit to perform the duties of his rank and grade at the time of his retirement, and that the denial by the Board of the application for correction of his records was not arbitrary or unreasonable and was otherwise correct, proper and supported by substantial evidence; and (2) that under the circumstances of this case, the failure of plaintiff to receive, as part of his retirement physical examination a special psychiatric examination did not violate any provision of statute or regulation and did not constitute substantial error. Assuming, *arguendo*, that such an omission be considered an error, it must be considered harmless error for the record here suports the view that any such psychiatric examination as part of plaintiff's retirement physical would have found him fit to perform the duties of his rank and grade at the time of his retirement. This case came before the court on plaintiff's exceptions to the said recommended decision, having been submitted on the briefs and oral argument of counsel. Upon consideration thereof, since the court agrees with the recommended decision, by order dated May 30, 1975 the court affirmed and adopted the same as the basis for its judgment in this case, concluded that plaintiff is not entitled to recover, and dismissed the petition.

No. 153-73. May 30, 1975

R. H. Fulton, Contractor

*Contracts; damages; defective workmanship; mutual fault.*—Plaintiff, a prime contractor, sues on behalf of its subcontractor, seeking to overturn a decision of the Interior Board of Contract Appeals which had concluded that the subcontractor was contractually liable for the costs of certain repair work based upon findings of defective workmanship on the part of the subcontractor. Plaintiff challenges the Board's decision both on factual and legal grounds. Trial Judge John P. Wiese, in a recommended opinion filed March 21, 1975 (reported in full at 21 CCF para. 83802), concluded that all factual findings made by the Board are based upon substantial evidence and are entitled to finality; that the Board committed certain errors of law that were critical to the conclusion of liability that it reached; that the factual findings, taken together with the correct legal standards, result in a conclusion of mutual fault on the part of the contractor and the Government; and that the contractor is entitled to a judgment reimbursing one-half of the amount that would otherwise be allowable, or, here, $89,707.80. The case came before the court on a stipulation of the parties in which it is stated that a written offer was submitted by plaintiff to the Attorney General and duly accepted on behalf of defendant, whereby plaintiff agreed to accept $89,507.80 in full settlement of all claims set forth in the petition, and defendant consented to entry of judgment in that amount. On May 30, 1975 the court ordered that judgment be entered for plaintiff in the sum of $89,507.80.

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No. 13-74. May 30, 1975

Dean R. Kellams

*Civilian pay; incidental and collateral relief.*—On May 30, 1975 the court issued the following order:

"This case comes before the court on a stipulation of settlement filed on May 15, 1975, signed by the respective attorneys of record, in which it is stated that a written offer was submitted by the plaintiff to the Attorney General and duly accepted on behalf of the defendant, whereby the plaintiff agreed to accept the sum of $27,000, to be allocated as provided below, in full settlement of all claims set forth in the petition, as amended, and the defendant consented to the entry of judgment in that amount, as well as the inclusion in the judgment order of certain directives contained in the stipulation, all as provided below.

"NOW THEREFORE, IT IS ORDERED that judgment be and the same is entered for plaintiff in the sum of twenty-seven thousand dollars ($27,000) with $3,054.08 thereof to be credited to plaintiff's Civil Service Retirement and Disability Fund account as matching contributions for the period April 26, 1971 through September 11, 1972 and the balance of $23,945.92 to be paid to plaintiff, and

"IT IS FURTHER ORDERED pursuant to Rule 147(c) and as provided in the said stipulation, that the agency, ACTION/Peace Corps, shall take the following corrective actions:

"(1) Cancel the SF-50 Notification of Personnel Action, dated April 29, 1971 providing for the termination of plaintiff under code 352 with the stated reason being for the 'convenience of the Government.'

"(2) Issue a new SF-50 dated September 11, 1972 in accordance with the provisions of Chapter 550, Federal Personnel Manual Subchapters 8-5 and 8-6, entitled 'Reporting Corrective Action,' providing for a voluntary change in assignment for plaintiff with ACTION/Peace Corps.

"(3) Expunge from its official personnel file folder of plaintiff, and take all steps necessary to trace, rescind, and destroy all copies of memoranda, correspondence and documents which allege a failure on plaintiff's part to attain a satisfactory language proficiency in French or that plaintiff had demonstrated an insensitivity to blacks or black Africans.

"(4) Issue a directive to the effect that any official charged with commenting on plaintiff's official records should state that plaintiff was terminated due to the expiration of his appointment (and, accordingly, plaintiff may answer question numbers 30 and 31 on the Civil Service Commission Standard Form 171 in the negative)."

**No. 54-74. MAY 30, 1975**

John Billmeyer, Trustee in Bankruptcy of the Estate of Inter-Helo, Inc.

*Contracts; interpretation; ambiguity; oral discussions at pre-award conference; practice of parties during contract performance.*—On May 30, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"Plaintiff is the trustee in bankruptcy of the estate of Inter-Helo, Inc., a Government contractor. Its dispute with the Interior Department, resolved against it below, is now before us under the Wunderlich Act, 41 U.S.C. §§ 321, 322 for review of a decision of the Interior Department Board of Contract Appeals. We conclude after briefing and oral argument that the Board has erred in its application of the parole evidence rule and that further proceedings before it must now ensue.

"The contract awarded was of the open-ended requirements type, for helicopter services to be used by defendant in surveying remote areas of the American West. It called for a minimum of 100 service hours, maximum 525, to be performed between November 6, 1967, through March 1, 1968, with a time extension period of 30 days. These figures were reduced by consent from figures originally stated in the bid invitation, because of Government financial stringency. Though defendant had the use of plaintiff's helicopters reserved exclusively for this contract, defendant paid only a figure per flying hour. Plaintiff claims it was agreed and understood beforehand that its helicopters, once work was started, would be used at a rate of 7 flying hours a working day, weather permitting, until the work was finished. The Board calculated that, within the contract, defendant without a breach could use the helicopters at as little as 1.33 hours per day. It deemed that showing any agreed larger figure was contrary to the parole evidence rule. Defendant's actual use worked out, per Board calculation, at over 5 hours per day through March 1, and thereafter 2.47, plaintiff having crashed a helicopter on February 27. Defendant increased its rate of use somewhat in response to plaintiff's complaints, though it asserted the agreed rate was 5 hours.

"Use at only a 1.33 hour rate would be absurd from every point of view. The written contract was manifestly incomplete in not specifying a daily rate of use, a matter vital to plaintiff since it could not use its helicopters for any other purpose during the contract life.

"Recent decisions of this court (since the Board opinion) make it clear that oral discussions at pre-award conferences, and the practice of the parties during performance, may be considered to resolve ambiguity in a contract or supplement it with additional terms. *Sylvania Elec. Products, Inc.* v. *United States*, 198 Ct. Cl. 106, 458 F. 2d 994 (1972); *Macke Co.* v. *United States*, 199 Ct. Cl. 552, 467 F. 2d 1323 (1972). The parole evidence rule by these authorities would bar plaintiff from varying the written terms of the contract or repudiating an express clause that the written contract embodies the entire agreement of the parties, neither of which does plaintiff attempt to do here, as we understand. The Board should have allowed plaintiff to show a pre-award agreement, or an express or implied concession as to rate of use. The record reflects, *e.g.*, apparently erroneous exclusion of a chart or plan, used by defendant as a basis for discussion, pre-award, that shows rates of use anticipated under several contracts (plaintiff had others than this) with a 7 hour rate for this one.

"We express no opinion whether the record, enlarged as we deem it should be, will show plaintiff is entitled to recover, or not.

"Accordingly, the cause is remanded to the Interior Department Board of Contract Appeals for further proceedings consistent with this order, under authority of Public Law 92-415, 86 Stat. 652, amending 28 U.S.C. § 1491. Pursuant to Rule 149, proceedings in this court shall be suspended for 6 months. Counsel for plaintiff is designated to give the advice as to the status of the proceeding on remand, per Rule 149 (f), at intervals of 90 days beginning with the date of this order."

No. 180-74. MAY 30, 1975

Hugh D. Jascourt

*Contracts; authority of Government agent; burden of proof.*—On May 30, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, MARKEY, *Chief Judge* of the United States Court of Customs and Patent Appeals, sitting by designation pursuant to 28 U.S.C. § 293(a), and LARAMORE, *Senior Judge.*

"This case comes before the court on cross motions for summary judgment. Upon consideration thereof and after hearing oral argument, the court finds:

"(1) In the Spring of 1973, plaintiff expended his personal funds in reliance on oral statements by representatives of the Department of Labor that he would be reimbursed for such expenditures;

"(2) the Deputy Assistant Secretary for Labor Relations, who was also the Acting Director of the Office of Labor Management Policy and Development, Department of Labor, directed his subordinate, who was the Director of the Division of Public Employees, Labor Management Services Administration, to inform plaintiff that a contract with plaintiff had been approved and funded;

"(3) the Director of the Division of Public Employees thereafter informed plaintiff that the contract had been approved and he authorized and directed plaintiff to undertake certain expenditures;

"(4) although both officials of the Department of Labor believed that the Deputy Assistant Secretary for Labor Relations had the authority to enter into the contract and obligate the Department of Labor to reimburse plaintiff for his financial undertakings, neither of said officials had actual authority to bind the Government by either written or oral contract. Under the regulations then in force, only duly designated contracting officers within the Division of Procurement, Office of Administrative Services of the Department of Labor, had the legal authority to contractually bind the Government, and no contract with plaintiff was executed or approved by an authorized official of the Government.

"On the basis of the foregoing, the court concludes that plaintiff has the affirmative burden of showing that the officials on whose statements he relied had the authority to commit the Government and having failed to discharge that burden, plaintiff may not recover. *Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 468 F.2d 922 (1972). Since these officials had no actual authority to bind the Government, plaintiff is not entitled to recover on a showing that he relied on their apparent authority. The regulations were published in the Federal Register, and plaintiff is deemed to have had notice that the officials with whom he dealt lacked contractual authority. *Federal Crop Ins. Corp.* v. *Merrill*, 332 U.S. 380, 384 (1947).

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, plaintiff's cross motion is denied, and plaintiff's petition is dismissed."

Plaintiff's petition for certiorari was denied December 15, 1975, 423 U.S. 1032.

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NO. 22-75. MAY 30, 1975

Delbert V. Mathis

*Military pay; limitation of actions; accrual of cause of action.*—On May 30, 1975 the full court issued the following order:

"This case comes before the court on plaintiff's suggestion, received February 18, 1975, for an initial consideration by the court *en banc* under Rule 7(c), of defendant's motion, filed March 24, 1975, to dismiss the petition and plaintiff's motions for judgment on the pleadings (filed March 31, 1975), for judgment by default (filed March 31, 1975) and to strike defendant's filing dated April 29, 1975 (filed May 7, 1975). Upon consideration thereof, without oral argument, the court makes the following findings:

"(1) Plaintiff, at one time a Lieutenant in the United States Air Force, was accused in 1956 of possessing an identification card, not his own, which was used to buy several items for resale on the black market in Japan. On April 30, 1958, a General Court-Martial found the plaintiff guilty and ordered that he be dismissed from the service with forfeiture of all pay and allowances. This ruling was upheld by the Board of Review of the Office of the Judge Advocate General in August, 1958, and plaintiff's petition for review was denied on December 2, 1958 by the United States Court of Military Appeals. On December 19, 1958, the ruling of the General Court-Martial to dismiss plaintiff from the service was made effective.

"(2) Approximately 11 years after the effective date of his dismissal from the Air Force, plaintiff began a series of requests of review of the General Court-Martial to the Air Force Board for the Correction of Military Records. These three requests were all denied by the Board. Plaintiff then filed suit in the District Court for the Northern District of California, where his suit was dismissed because the court lacked jurisdiction to consider his claims. On September 4, 1973, the United States Court of Appeals for the Ninth Circuit upheld the dismissal of plaintiff's suit, since it found that this court had exclusive jurisdiction over plaintiff's claims. Plaintiff did not file suit in this court until January 24, 1975.

"(3) From the foregoing facts, it is clear that any claim or cause of action dealing with plaintiff's discharge from the Air Force accrued as of December 9, 1958, the effective date of plaintiff's dismissal. *See Kirby* v. *United States*, 201 Ct. Cl. 527 (1973), *cert. denied*, 417 U.S. 919 (1974); *Mathis* v. *United States*, 183 Ct. Cl. 145, 391 F. 2d 938 (1968); *Friedman* v. *United States*, 159 Ct. Cl. 1, 310 F. 2d 381 (1962), *cert. denied*, 373 U.S. 932 (1963). Plaintiff's applications to the Correction Board were permissive in nature and do not toll the pertinent statute of limitations. *See Kirby* v. *United States*, *supra*, at 531; *Mathis* v. *United States*, *supra*, 183 Ct. Cl. at 147, 391 F. 2d at 939; *Dayley* v. *United States*, 169 Ct. Cl. 305, 308 (1965).

"(4) Since plaintiff did not file his claim in this court until approximately 16 years after his formal date of discharge from the Air Force, his claim is barred by the six-year statute of limitations found in 28 U.S.C. § 2501 (1970).

"IT IS THEREFORE ORDERED that plaintiff's motions for judgment on the pleadings, for judgment by default and to strike defendant's filing of April 29, 1975, are denied; that defendant's motion to dismiss is granted; and that plaintiff's petition is dismissed."

APP. NO. 3-74. MAY 30, 1975

James Strong, et al.

*Appeal from Indian Claims Commission; Royce Areas 53 and 54.*—The consolidated proceedings before the Indian Claims Commission involved determination of title claims by the various plaintiffs to the areas identified as 53 and 54 on Royce's map of Ohio. Representatives of several Indian tribes relinquished their interests in these areas at the Treaty of Fort Industry, July 4, 1805, 7 Stat. 87. On May 30, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on appeal by various Indian Tribes from decisions and orders of the Indian Claims Commission in 30 Ind. Cl. Comm. 8 of April 4, 1973 and 31 Ind. Cl. Comm. 359 of September 19, 1973. After consideration of the record, the briefs, and oral argument of counsel, the court concludes that while it would have been helpful if the findings of fact could have been fuller and more extensive, the findings as made support the decision and order of the Commission and the same are supported by substantial evidence. We conclude further that there is no error of law in the decisions and orders of the Commission and that the same should be affirmed.

"Accordingly, the decisions and orders of the Commission are approved and affirmed, and the case is remanded to the Commission for further procedings in accordance with this order."

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BENNETT, *Judge*, dissenting.

"I agree with the majority when it says that 'it would have been helpful if the findings of fact could have been fuller and more extensive.' I dissent from the conclusion that notwithstanding the paucity of the findings they are nevertheless supported by substantial evidence. I do not know how you can tell. They are conclusory in nature and so abbreviated as to leave one wondering on what they are based or how arrived at. Surely, on a record so large, the triers of the facts could give an appellate court better guidance. There were many weeks of hearings, thousands of pages of transcript and hundreds of exhibits. A dozen parties, including defendant, are involved. On this the Commission gives us eight short findings and three conclusions of law on 12 pages. The claims are hotly contested in nine briefs filed with the court.

"25 U.S.C. § 70s charges this court on appellate review to determine (1) whether the findings of fact of the Commission are supported by substantial evidence and (2) whether the Commission's conclusions of law are supported by its findings. I would hold that on their face these findings and conclusions do not permit such review as required by the statute and would remand to the Commission for an appropriate report which would make the appellate review something less than 'a cop-out' in the opinion of some of the parties who so described the Commission's findings and conclusions. I know that my colleagues in good faith feel otherwise. I simply cannot share their confidence and optimism although I respect it and share their concern about further delay in the case."

The joint motion for rehearing *en banc* filed by the Delaware, Ottawa and Seneca-Cayuga was denied October 10, 1975. Petition for certiorari denied March 29, 1976.

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APP. NO. 4-74. MAY 30, 1975

James Strong, et al.

*Appeal from Indian Claims Commission; Royce Areas 87 and 88.*—The consolidated proceedings before the Indian Claims Commission involved determination of recognized title by the various plaintiffs to the areas identified as 87 and 88 on Royce's map of Ohio, Indiana and Michigan. Representatives of several tribes and bands of Indians relinquished their interests in these areas at the Treaty of September 29, 1817, 7 Stat. 160. On May 30, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case comes before the court on appeal by various Indian Tribes from decisions and orders of the Indian Claims

Commission in 30 Ind. Cl. Comm. 337 of May 23, 1973 and 31 Ind. Cl. Comm. 359 of September 19, 1973. After consideration of the record, the briefs, and oral argument of counsel, the court concludes that while it would have been helpful if the findings of fact could have been fuller and more extensive, the findings as made support the decision and order of the Commission and the same are supported by substantial evidence. We conclude further that there is no error of law in the decisions and orders of the Commission and that the same should be affirmed.

"Accordingly, the decisions and orders of the Commission are approved and affirmed, and the case is remanded to the Commission for further proceedings in accordance with this order."

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BENNETT, *Judge*, dissenting.

"The views expressed in my dissent in *James Strong*, *et al.* v. *United States*, Appeal No. 3–74, *ante at* 958–59, are adopted here by reference. I think in all sincerity what the Commission has attempted here is to do 'rough justice' but it is too rough to be just. I would remand."

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The joint motion for rehearing *en banc* filed by the Ottawa, Seneca-Cayuga, Potawatomi (Prairie Band) and the Potawatomi (Citizens Band) was denied October 10, 1975. Petition for certiorari denied March 29, 1976.

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APP. NO. 5–74. MAY 30, 1975

Saginaw Chippewa Indian Tribe of Michigan, et al.

*Appeal from Indian Claims Commission; Royce Area 66.*—The consolidated proceedings before the Indian Claims Commission involved determination of title claims by various plaintiffs to the area identified as area 66 on Royce's maps of Michigan and Ohio. Representatives of several Indian tribes and bands relinquished their interests in this territory at the Treaty of Detroit, November 17, 1807, 7 Stat. 105. On May 30, 1975 the court issued the following order:

Before **Skelton**, *Judge*, Presiding, **Kunzig** and **Bennett**, *Judges*.

"This case comes before the court on appeal from decisions and orders of the Indian Claims Commission in 30 Ind. Cl. Comm. 388 of June 13, 1973. After consideration of the record, the briefs, and oral argument of counsel, the court concludes that while it would have been helpful if the findings of fact could have been fuller and more extensive, the findings as made, except with reference to the intervention of the Potawatomi of the Huron and Albert N. Mackety, et al., as Members and Representatives of the Huron Potawatomi Band, support the decisions and orders of the Commission and the same are supported by substantial evidence. We conclude further that there is no error of law in the decisions and orders of the Commission, except with reference to allowing the plea in intervention aforesaid, and that the decisions and orders should otherwise be affirmed.

"We conclude that an error of law was committed by the Commission in allowing the Potawatomi of the Huron, et al., to intervene in this case 20 years, more or less, after their claim was barred by limitations and such claim was adverse to that of the other Potawatomi Tribes whose claim was timely filed. This is contrary to our decision in *Kiowa, Comanche and Apache Tribes* v. *United States*, 202 Ct. Cl. 29, 479 F.2d 1369 (1973), *cert. denied*, 416 U.S. 936 (1974). However, in fairness to the Commission, it should be pointed out that the decision of the Commission was entered one week before our decision in the above case was handed down. The plea in intervention aforesaid must be dismissed.

"Accordingly, the decisions and orders of the Commission are approved and affirmed, except as to the allowance of said plea in intervention, and the case is remanded to the Commission with directions to dismiss said plea in intervention, and for further proceedings in accordance with this order."

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**Bennett**, *Judge*, dissenting.

"The findings and conclusions in this case suffer from the same infirmities described in my dissents in *James Strong, et al.* v. *United States*, Appeal No. 3–74, *ante* at 958–59, and Appeal No. 4–74, *ante* at 960. I adopt by reference the views expressed there. I do, however, agree with the majority as to its position on the intervention issue."

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The "application" (motion) by the Ottawa appellants for rehearing *en banc* was denied October 10, 1975.

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NO. 157-74. JUNE 13, 1975

Larry C. Sanders

*Military pay; correction of military records; complete relief; remand to administrative board; leave to take depositions.*—On June 13, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and BENNETT, *Judges*.

"This case is before the court on (1) plaintiff's request for review of the trial judge's supplemental pre-trial order of April 10, 1975, holding that plaintiff may not take the testimony of three members of the Air Force Board for Correction of Military Records (AFBCMR), such testimony having been ruled inadmissible for the purposes set forth in plaintiff's offer of proof, and (2) plaintiff's motion asking that the court reconsider its order of November 22, 1974, which affirmed the trial judge's order denying plaintiff the opportunity to require answers by members of the Board to certain interrogatories.

"Plaintiff's application for correction of his military record asked for voidance of four officer effectiveness reports and removal from his records of two non-selections or passovers to the grade of temporary major. Plaintiff shows to the court that on November 22, 1971, the Secretary on recommendation of the Correction Board voided the effectiveness reports, but took no action on and made no reference to the passovers alleged to have been predicated on the erroneous OER's. Plaintiff on November 21, 1973, requested that the Board reconsider his application for removal of the two passovers and enlarged his application by seeking his removal of the two permanent non-selections to major, the second of which had taken place during the pendency of his previous application to the Board. Plaintiff asked that his record be amended to show him as having been selected for both temporary and permanent major. On March 29, 1974, the Board by letter denied the application without a hearing, stating simply that plaintiff had failed to submit sufficient evidence to establish a showing of probable error or injustice in the case. Suit for back pay was filed on May 1, 1974, and the aforesaid discovery efforts followed.

"Upon consideration of the orders of the trial judge, the request for review and motion to reconsider, and defendant's opposition thereto, we conclude that the request and the motion should be denied. However, the court is unable to ascertain why the Board granted plaintiff partial relief by voiding the erroneous OER's but not the passovers which they allegedly occasioned. The Board held no hearing and made no findings or reference to the passovers in its decisions in either 1971 or 1974. The Secretary of the Air Force in acting on the recommendation of the Board made no reference to the passovers which are claimed to be the end result of the defective OER's and to have caused plaintiff's promotion failures. The request for relief as to the passovers was neither approved nor denied. We think that the Board should reconsider this matter and state its reasons, if any, for not mentioning the passovers and should state why it is not necessary to void them in order to give plaintiff complete relief from the error and injustice caused by the defective OER's, which were set aside.

"On the basis of the record before us, there is substantial doubt that the Board adhered to its own liberal mandate to correct errors in and remove injustice from plaintiff's military personnel record. *Riley* v. *United States*, 204 Ct. Cl. 865 (1974). We have previously held that a Secretary and his Boards have an abiding moral sanction to determine, insofar as possible, the true nature of an alleged injustice and to take steps to grant thorough and fitting relief. *Duhon, Jr.* v. *United States*, 198 Ct. Cl. 564, 570, 461 F. 2d 1278 (1972). In the context of other factual situations we have also held that once a Board decides to correct a record and to grant relief "* * * it should not be free to slice the relief illegally or arbitrarily, sending the claimant forth with half-a-legal-loaf or even less." *DeBow* v. *United States*, 193 Ct. Cl. 499, 504, 434 F. 2d 1333 (1970), *cert. denied*, 404 U.S. 846 (1971); *Ray* v. *United States*, 197 Ct. Cl. 1, 453 F. 2d 754 (1972); *Denton* v.

*United States*, 204 Ct. Cl. 188, *cert. denied*, 421 U.S. 963 (1975); *Yee* v. *United States*, 206 Ct. Cl. 388, 512 F. 2d 1383 (1975). Further, the court has found that there must be satisfactory indication that a correction board's decision is based "upon a balanced consideration of all the evidence available and presented." *Smith* v. *United States*, 168 Ct. Cl. 545, 553 (1964).

"IT IS THEREFORE ORDERED that plaintiff's request for review and motion for reconsideration be and they are hereby denied.

"IT IS FURTHER ORDERED that pursuant to Pub. L. 92–415, 86 Stat. 652, 28 U.S.C. § 1491 (Supp. III 1973), the foregoing authorities, and Court of Claims Rule 149, the case is remanded to the Air Force Board for Correction of Military Records with instructions to reconsider the case consistent with the views expressed in this order; and to make findings of fact showing the basis for its conclusions on such reconsideration.

"In its reconsideration of plaintiff's application for relief, the Board shall consider the record heretofore made, and in its discretion, may grant a hearing and consider such other evidence and materials as may properly be presented by the parties.

"After completion of the Board's proceedings, the record thereof will be presented in normal course for action by the Secretary of the Air Force.

"Counsel for the plaintiff is designated under Rule 149 (f) to advise the trial judge and opposing counsel of the status of procedings on remand at intervals of 90 days or less, beginning with the date of this order.

"These proceedings are stayed for a period not to exceed six months from the date of this order, pending the Board's reconsideration upon remand."

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**No. 102–63. JUNE 20, 1975**

Jessie Short, et al.

*Indian claims; Government liability for payment to Indians entitled to recover; individual Indian's burden of proving entitlement.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case comes before the court on defendant's request for review of the order of the trial judge dated May 2, 1975, which stated, among other things:

> 1. In pursuance of the adjudicated liability of the defendant United States, through the Department of Interior, to make payments, in lawful amount, of the income of the Hoopa Valley Reservation to those of the plaintiffs entitled to recover in this case, and the duty of the Government as defendant to confess judgment in favor of those of plaintiffs whom it deems entitled to recover, the Government as defendant is directed to devote all reasonable efforts towards identifying and recognizing those plaintiffs entitled to recover, including without limitation the provision of assistance to plaintiffs in the gathering and processing of the questionnaires now being circulated to plaintiffs to show their eligibility to recover.
>
> In light of the adjudicated error of United States as trustee in making payments, since at least 1958, to a group smaller than those entitled, it is incumbent upon defendant to exert its best efforts to expedite the recognition or litigation of questions of eligibility which remain for disposition in this case.
>
> * * * * *
>
> 4. The defendant and the Intervenor are directed within 3 months to file a statement of the standards—blood, residence and any others—they propose to espouse to govern the determination of eligibility. The plaintiffs are within two months thereafter to file a responsive memorandum.

"Defendant's request for review and plaintiffs' response thereto have been submitted to the court on briefs without oral argument. Upon consideration thereof, the court is of the opinion that notwithstanding the prior decision of this court [202 Ct. Cl. 870, 486 F. 2d 561 (1973), *cert denied*, 416 U.S. 961 (1974)], adjudicating liability of the United States to make payments, in lawful amount, of the income of the Hoopa Valley Reservation to those plaintiffs entitled to receive them, the case is still an adversary proceeding by a number of individuals against the Government, and these individuals have the burden of proving their entitlement to payments; the Government does not have this burden. The

Government has no obligation to these plaintiffs except to make available to them such pertinent records as are available to the Government. The plaintiffs must prove their own claims and the Government is not required to make such proof for them, and this court is without authority to require the Government to prosecute the claims of the plaintiffs for them.

"It is therefore concluded and ordered that defendant's request for review is granted and the order of the trial judge of May 2, 1975, is set aside and the case is remanded to the trial judge for further proceedings in accordance with this order."

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KUNZIG, *Judge*, dissenting.

"I respectfully dissent. In *Jessie Short*, *et al.* v. *United States*, 202 Ct. Cl. 870, 486 F.2d 561 (1973), *cert. denied*, 416 U.S. 961 (1974), we held the Government liable to qualified members of the Hoopa Valley Reservation who were entitled to, but did not receive, income from the sale of reservation timber. We recognized the United States, as trustee for Indians, had a duty to insure a fair share distribution of reservation revenue to *all* qualified members of the Hoopa Valley Reservation. In my view, inherent in that decision was the requirement that the Government, in its fiduciary capacity, should henceforth take every necessary step to insure that all eligible members were credited with a fair share of subsequent revenues. By requiring defendant United States to aid plaintiffs' counsel in identifying eligible recipients, Trial Judge Schwartz did nothing more than require the Government to live up to its fiduciary duty. As such, I do not find the defendant's burden of proof argument persuasive and see no good reason for setting aside the order of the trial judge of May 2, 1975."

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NO. 119-68. JUNE 20, 1975

Cosmo Construction Co. and The First National Bank & Trust Company of Tulsa

*Contracts; breach; claim of Government delay in investigating changed conditions.*—This case was before the court previously on the parties' motions for summary judgment (194 Ct. Cl. 559, 439 F. 2d 160 (1971)), and upon remand to the trial judge has been tried on its merits. The issue is whether or not defendant breached the contract by unreasonable inaction or delay in investigating so-called "changed conditions" called to its attention, and by failure to provide plaintiff with sufficiently precise new directions, so as to idle the latter's equipment and frustrate its full utilization. In a recommended decision filed March 5, 1975 (reported in full at 20 CCF para. 83772), Trial Judge Louis Spector concluded that on the basis of the evidence presented at trial plaintiff promptly notified the contracting officer in writing of subsurface conditions at the site differing materially from those indicated in the contract, that the contracting officer promptly investigated the conditions and took steps to rectify them, that plaintiff has not shown any delay or damage caused by Government action or inaction in providing instructions following discovery of "changed conditions," and that defendant did not breach its duty of due care in the original preparation of plans and specifications, nor its duty to promptly investigate changed conditions and promptly to provide plaintiff with revised instructions. On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before us on the motion of defendant to adopt the opinion of the trial judge with certain requested modifications. Neither the plaintiff nor the defendant excepted to the decision of the trial judge.

"We conclude that the opinion of the trial judge should be adopted as written. While we have considered the modifications requested by defendant, even though not presented as exceptions to the opinion of the trial judge, we have concluded that such modifications should not be made. The court will always consider suggestions for modification of opinions, but we reserve judgment as to whether to allow or deny them. See *Owens-Corning Fiberglas Corp.* v. *United States*, 188 Ct. Cl. 760, 412 F. 2d 1277 (1969).

"Accordingly, defendant's motion to adopt the trial judge's opinion is allowed and the opinion is adopted. However, that part of said motion requesting modifications is denied. The petition is dismissed."

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No. 343-72. JUNE 20, 1975

Weather Engineering Corporation of America and Weather Engineering Corporation of Canada, Ltd. (New Mexico State University, South Dakota School of Mines and Technology, and South Dakota Department of Natural Resource Development, Third-party Defendants)

*Patents; infringement.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"In this case the plaintiff sues the United States for infringing its patent relative to a cloud seeding process to produce rain. New Mexico State University, South Dakota School of Mines and Technology and South Dakota Department of Natural Resource Development were made third party defendants and served with notice as such. Each of them has filed a motion for summary judgment accompanied by an affidavit showing they have not infringed plaintiff's patent in any way. The plaintiff agrees, and asserts it has no claim against such defendants and does not oppose their motions for summary judgment.

"Accordingly, we allow the motions for summary judgment of said third party defendants and dismiss plaintiff's suit against them, and also dismiss the third party proceedings and claims of the United States against said third party defendants."

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APP. No. 13-74. JUNE 20, 1975

The Hopi Tribe

*Indian claims; appeal from Indian Claims Commission; issuance of order staying proceedings before Indian Claims Commission; when appropriate.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"In this case the Government has filed a motion for a stay of proceedings relating to count 9 of Docket 196, *Hopi Tribe* v. *United States*, before the Indian Claims Commission during the pendency of the present appeal. The only question before us is whether or not to issue such a stay of proceedings. The essential facts are stated briefly as follows:

"On June 29, 1970, the Commission entered an order determining the issue of aboriginal title to land claimed by the Hopis and dates of extinguishment thereof, 23 Ind. Cl. Comm. 277 (1970). On April 23, 1974, the Hopi Tribe filed a notice of appeal to this court from the decision of the Commission of June 29, 1970, and such appeal was docketed in this court as Appeal No. 13–74, which is the present case.

"After the filing of the appeal here, the Commission entered an order on March 13, 1975, directed to count 9 of Docket 196, the general accounting claim of the Hopi Tribe, requiring the tribe to file a more definite statement of its exceptions to the Government's accounting report and alleging with particularity the wrongful acts that the tribe alleged occurred before August 13, 1946, and continued thereafter. The tribe was originally required to file this more definite statement by July 1, 1974, but this time limit was extended by the above order of March 13, 1975, whereby the tribe was allowed to file a statement out of time and the Government was ordered to respond to the same within 60 days from the date of the order.

"The Government opposed the motion of the tribe for leave to file out of time contending that the Commission lacked jurisdiction over Docket 196 once the appeal had been taken to this court. The Government contended before the Commission that the issues on appeal to the Court of Claims had a direct interrelationship with the accounting claim in Docket 196 upon which the Commission and the tribe proposed to proceed before the Commission during the pendency of the present appeal. The Government also requested a stay of proceedings before the Commission because of the interrelationship of the present appeal to the tribe's general accounting claim. The Commission denied the motion to stay proceedings and the Government now requests this court to issue an order staying the proceedings before the Commission pending the disposition of the present appeal.

"It should be noted that the Commission has not entered an order severing count 9, the general accounting claim of the tribe from the other claims contained in the original petition in Docket 196.

"The Government points out that in count 9 the Hopi Tribe is seeking, among other things, an accounting for rights of way, revenues received through leasing, mining, and other transactions producing funds and it seeks such accounting beyond the jurisdictional date of August 13, 1946. If in the present appeal the Commission's determination that the tribe's title to Area B was extinguished on June 2, 1937, is affirmed, the United States would not have to account for such lands after that date. On the other hand, if the Commission is not so affirmed, the extent of the accounting will be a complicated problem. Until the land area of the Hopi Tribe and the dates of extinguishment of title are finally determined, it will not be possible for the Government to render an accurate accounting and there will be a lot of wasted effort by all parties as well as by the Commission. Therefore, it appears that the Government's contention that the present appeal does raise questions going to the merits of the tribe's general accounting claim so that count 9 pertaining thereto is not an independent action within the jurisdiction of the Commission.

"Accordingly, it appears that the Commission is without jurisdiction to proceed further in the case until the present appeal is disposed of. Even if it would be assumed that the Commission has jurisdiction to proceed with the general accounting claim, the interrelationship and interdependency of the general accounting claim and the issue involved in the present appeal requires that we issue an order to the Commission staying further proceedings before it on the accounting claim until the present appeal is disposed of.

"The rules of the Court of Claims do not provide a specific way to stay proceedings before the Indian Claims Commission, however, Rules 8(a) and 18 of the Federal Rules of Appellate Procedure can be applied in granting such a stay of proceedings. *See Seminole Indians* v. *United States*, 200

Ct. Cl. 417, 421–22, 471 F.2d 614, 616 (1973). Also see 5 U.S.C. § 705 (1970) and notes of the Advisory Committee on Appellate Rules with reference to Rule 18 regarding the question of stays of agency action issued by appellate courts. It appears that the Government has complied with Rules 8(a) and 18 aforesaid by first asking for a stay before the Commission which was denied and now moves for such a stay in this court.

"Accordingly, we hereby issue a stay order requiring the Indian Claims Commission to stay all proceedings relating to count 9 of Docket 196 until the present appeal is disposed of by this court."

On March 26, 1976 six active judges of the court denied appellant's suggestion for rehearing *en banc*, and the panel consisting of SKELTON, NICHOLS and BENNETT, *Judges*, denied appellant's motion for rehearing.

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No. 92–74. JUNE 20, 1975

Gulf Refining Company

*Court of Claims jurisdiction; admiralty claim.*—Plaintiff seeks to recover clean-up costs incurred in cleaning up an oil spill discharged from a vessel plaintiff neither owned nor operated, plaintiff having been allegedly directed by a representative of defendant to do so during an oil cleanup necessitated by discharge of crude oil from a pipeline owned and operated by plaintiff. On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case comes before the court on defendant's motion, filed March 25, 1975, for summary judgment. Upon consideration thereof, together with the response in opposition thereto, without oral argument, it is concluded that plaintiff's petition fails to comply with the jurisdictional requirements of 33 U.S.C. § 1161(i) applicable to this court.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted without prejudice to the adjudication elsewhere of any admiralty claims plaintiff might possess.

"IT IS FURTHER ORDERED that pursuant to the provisions of 28 U.S.C. § 1506 and the decisions in *Brady* v. *Roosevelt S.S. Co.*, 317 U.S. 575, 578–79 (1943), and *Alaska Barge & Transport, Inc.* v. *United States*, 179 Ct. Cl. 216, 373 F.2d 967 (1967), plaintiff's admiralty claims set forth in its petition are transferred to the United States District Court for the Eastern District of Texas.

"The clerk of this court will forward to the clerk of that court a certified copy of the record made here."

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**No. 220–74. JUNE 20, 1975**

John R. Sherman

*Claim against United States.*—Plaintiff's petition, as amended, claims that the Government allegedly misused certain unpatented inventions which plaintiff allegedly made under an HEW predoctoral fellowship, and also claims that HEW, NIH "refused to properly and fully review same Grant Application (possibly) resulting in unjust enrichment to the United States of America Government and grantees." In a supplemental petition, filed June 4, 1975, plaintiff seeks, *inter alia*, refund of copyright and patent application filing fees, asserting certain irregularities by the Government in reviewing the applications, and that he "continues to be distracted and very mentally disturbed by crimes and harassments against [plaintiff]." On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges*.

"This case comes before the court on defendant's motion, filed March 24, 1975, for summary judgment to dismiss the claims alleged in plaintiff's petition, as amended, and on the court's own motion, under Rule 102(b)(1), as to plaintiff's supplemental petition, filed June 4, 1975. Upon consideration thereof, together with plaintiff's objections to defendant's motion for summary judgment, without oral argument, it is concluded that as to the claims set forth in plaintiff's petition, as amended, plaintiff is not entitled to recover on the basis of 28 U.S.C. § 2401, Court of Claims Rule 101(f) and the decision in *United States* v. *King*, 395 U.S. 1 (1969) and that as to the claims asserted in plaintiff's supplemental petition, filed June 4, 1975, plaintiff is not entitled to recover on the basis of the decision by this court in *Weir* v. *United States*, 200 Ct.Cl. 501, 474 F.2d 617, *cert. denied* 414 U.S. 1066 (1973).

"IT IS THEREFORE ORDERED that defendant's motion, filed March 24, 1975, for summary judgment is granted and plaintiff's petition, as amended and plaintiff's supplemental petition, filed June 4, 1975, are dismissed."

Plaintiff's motion for relief from judgment or order, request for permission to amend petition, and motion for rehearing were denied October 10, 1975.

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No. 380–74. JUNE 20, 1975

Aviation Contractors, Inc. and John A. Schneck

*Exercise of sovereign power; seizure of helicopter; violation of Federal Aviation Regulations.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before the court on defendant's motion for summary judgment which challenges our jurisdiction over plaintiffs' claim of a taking compensable under the fifth amendment on the grounds that it is really a tort claim. Plaintiffs owned a helicopter which was seized on October 12, 1972, by defendant to enforce a lien on account of the helicopter's use in alleged violation of federal aviation regulations for which civil penalties may be imposed. See 49 U.S.C. §§ 1430(a), 1473(b); 14 C.F.R. §§ 91.39 and 133.11. The helicopter was returned to plaintiffs on May 31, 1974, when they posted a security bond. Plaintiffs allege as the basis of a claim of permanent taking that their aircraft was damaged beyond repair while in defendant's possession because defendant did not exercise a proper degree of care. Plaintiffs claim several millions of dollars in direct, consequential, and special damages including lost anticipated profits and damages for 'grievous and continuous pain, suffering, and mental anguish.'

"It is defendant's position that its action was an authorized exercise of sovereign power, akin to police power, which is not compensable as a taking for public use would be. It points out that no public use was made of the helicopter. In this defendant is correct. *Franco-Italian Packing Co.* v. *United States*, 130 Ct. Cl. 736, 745–46, 128 F. Supp. 408, 413–14 (1955); *Finks* v. *United States*, 184 Ct. Cl. 480, 489, 395 F. 2d 999, 1003–004, *cert. denied*, 393 U.S. 960 (1968). A seizure or forfeiture statute helps to compensate the Government for its authorized enforcement efforts or provides security for penalties and fines. *Calero-Toledo* v. *Pearson Yacht Leasing Co.*, 416 U.S. 663, n. 26 at 687 (1974); *Doherty* v. *United States*, 205 Ct. Cl. 34, 500 F. 2d 540 (1974). Invocation of the due process clause of the fifth amendment is not enough to confer jurisdiction on this court, without more. *Eastport S.S. Corp.* v. *United States*, 178 Ct. Cl. 599, 605–07, 372 F. 2d 1002, 1007–009 (1967).

"Careless performance of a duty allegedly owed sounds in tort. *United States* v. *Neustadt*, 366 U.S. 696 (1961); *Somali Development Bank* v. *United States*, 205 Ct. Cl. 741, 508 F. 2d 817 (1974); *Columbia Basin Orchard* v. *United States*, 132 Ct. Cl. 445, 452, 132 F. Supp. 707, 710 (1955). The Court of Claims has no tort jurisdiction. 28 U.S.C. § 1491; *Myers* v. *United States*, 206 Ct. Cl. 863 (1975). Nor are consequential damages allowable even if there is a taking. *Hartwig* v. *United States*, 202 Ct. Cl. 801, 485 F. 2d 615 (1973); *R. J. Widen Co.* v. *United States*, 174 Ct. Cl. 1020, 357 F. 2d 988 (1966). Lost anticipated profits are likewise not recoverable in such cases. *United States* v. *General Motors Corp.* 323 U.S. 373 (1945).

"Plaintiffs also assert a temporary taking for the period from seizure until return of their aircraft. The court rejects this allegation because the period of deprivation was within plaintiffs' control at all times. Under the statute, 49 U.S.C. § 1473(b)(3) they could have regained their aircraft by paying the penalty, or by posting bond at nominal cost, which they ultimately did. We express no opinion on the validity of the regulations or statutes under which the seizure was effected or about the due process of the seizure. These matters were not briefed to us and are in litigation elsewhere.

"There is no dispute before the court as to any material fact necessary to decide the pending motion.

"IT IS THEREFORE ORDERED that, upon consideration of defendant's motion for summary judgment and plaintiffs' responses thereto and upon authority of the statutes and cases cited and for the reasons above, without oral argument, defendant's motion for summary judgment be and the same is granted. The petition is dismissed."

Plaintiffs' motion for modification of the foregoing order was denied October 10, 1975.

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No. 416-74. JUNE 20, 1975

Renate M. E. Sharp

*Military pay; involuntary discharge; laches; accrual of cause of action; pregnancy; Air Force Regulations.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"The plaintiff was a married woman and serving as a captain in the United States Air Force Reserve as a judge advocate. In April 1968, or thereabout, plaintiff, while married, became pregnant. She was involuntarily discharged from the Air Force on December 20, 1968, pursuant to mandatory Air Force Regulation 36-12, paragraph 40(a), of August 1, 1963, as amended, and effective on December 20, 1968. This regulation required a woman officer to be discharged when a determination was made by a medical officer that she was pregnant. A copy of the regulation is attached to defendant's motion for summary judgment. The plaintiff was discharged while on assignment to Germany where her husband was also serving as an officer in the Air Force. She remained in Germany after discharge until her husband finished his tour of duty and they both returned to the United States.

"The facts show that the plaintiff, being an attorney, was mindful of the fact that she might have a claim for wrongful discharge based on the Constitution because of unequal treatment afforded to women as compared to men in the military service. This is shown by the fact that she closely monitored and watched other cases that were filed in court involving the same problem. However, she did nothing in her own behalf until March 14, 1974, when she applied to the Air Force Board for the Correction of Military Records. On November 4, 1974, the Board denied her application. She then filed suit in this court on December 4, 1974, for backpay claiming that she was wrongfully discharged under an unconstitutional regulation.

"It is clear that her claim accrued no later than December 20, 1968. *See Kirby* v. *United States*, 201 Ct. Cl. 527 (1973), *cert. denied*, 417 U.S. 919 (1974). Accordingly, she waited five years, 11 months, and 15 days before filing suit here. The Government pleads laches citing *Brundage* v. *United States*, 205 Ct. Cl. 502, 504 F. 2d 1382 (1974), *reh. denied*, 206 Ct. Cl. 823 (1975), *cert. denied*, 421 U.S. 998 (1975). In that case we held in clear and unequivocal terms that laches is applicable to military pay cases. In that case the plaintiff waited three years and eight months before filing suit and we held that his claim was barred by laches. We also held in that case that the longer the period of delay the less prejudice must be shown by the defendant in order that it can prevail under the laches doctrine. In that case we held that the fact that another officer was required to perform the duties formerly performed by the plaintiff and drawing the salary that the plaintiff claimed should be paid to him was a sufficient showing of prejudice to invoke the laches doctrine.

"In addition to relying on laches, the defendant says that plaintiff's petition does not state a claim upon which relief can be granted citing the following cases similar to the one before us, all of which were decided adversely to the plaintiffs except the *Robinson* case. These cases are as follows: *Struck* v. *Secretary of Defense*, 460 F.2d 1372 (9th Cir. 1971), *cert. granted*, 409 U.S. 947, *vacated and remanded to consider issue of mootness*, 409 U.S. 1071 (1972); *Crawford* v. *Cushman*, 378 F. Supp. 717 (D. Vt. 1974); *Gutierrez* v. *Laird*, 346 F. Supp. 289 (D.D.C. 1972); *see Flores* v. *Secretary of Defense*, 355 F. Supp. 93 (N.D. Fla. 1973); *contra, Robinson* v. *Rand*, 340 F. Supp. 37 (D. Colo. 1972). The plaintiff was familiar with these cases and had watched their progress through the court while doing nothing to file suit in her own behalf. This is certainly sufficient to invoke the doctrine of laches against her because of our decision in *Reynolds Metals Co.* v. *United States*, 194 Ct. Cl. 309, 316–17, 438 F. 2d 983, 987, *cert. denied*, 404 U.S. 825 (1971), where the Reynolds Metals Company sat idly by and allowed Kaiser Aluminum & Chemical Corporation to litigate a similar claim. By doing so, Reynolds allowed its claim to become barred by limitations. However, in its suit here it claimed that since Kaiser recovered on an identical claim, Reynolds should be given the same treatment. We held that its claim was barred by limitations and that it should have filed suit like Kaiser did. In like manner in the case before us, the plaintiff should have filed her own suit instead of allowing others to litigate the same question.

"The plaintiff relies on two recent Supreme Court cases in her contention that the regulation requiring her discharge was unconstitutional. These cases are *Frontiero* v. *Richardson*, 411 U.S. 677 (1973) and *Cleveland Board of Education* v. *LaFleur*, 414 U.S. 632 (1974). However, these cases can be distinguished. In the *Frontiero* case the court was concerned with the different standards of eligibility applied to men and women in the military service in order for them to qualify for a dependent's allowance. That is not the same situation that we have here. In the *LaFleur* case the problem dealt only with civilians, while the regulation in the case before us was applicable only to military personnel. The Supreme Court has recently held that restrictions that may be unconstitutional as applied to civilians are constitutionally permissible when applied to military personnel. *See Parker* v. *Levy*, 417 U.S. 733 (1974). Also, in *Schlesinger* v. *Ballard*, 419 U.S. 498 (1975), the Supreme Court in distinguishing *Frontiero* held that it was not unconstitutional for the military service to treat men and women that were differently situated in a different manner. It is obvious that a pregnant female officer is differently situated from male officers.

"The case is before us on defendant's motion for summary judgment.

"Defendant's motion for summary judgment is allowed, without oral argument, because plaintiff's suit is barred by laches, and plaintiff's petition is dismissed. *Brundage* v. *United States*, *supra*."

No. 17-75. JUNE 20, 1975

John J. McGrath

*Court of Claims jurisdiction; reward for information relating to violations of Internal Revenue laws; administrative discretion.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case comes before the court on defendant's motion filed March 21, 1975, for dismissal of the plaintiff's petition upon the grounds that plaintiff has failed to state a claim upon which relief can be granted and that the court has no jurisdiction. Plaintiff is in default in responding to the motion, but, as plaintiff has sued *pro se*, we do not dismiss on that account.

"'Plaintiff claims a reward for information given to the District Director, Internal Revenue Service, New Jersey, and others, which allegedly resulted in substantial recovery of fines, penalties, forfeitures, and back taxes by defendant. Plaintiff relies upon the Administrative Procedure Act to give the court jurisdiction and upon the Internal Revenue Code of 1954, 26 U.S.C. § 7623, and Treasury Regulations, 26 C.F.R. § 301.7623-1, which authorize the Secretary of the Treasury or his delegate (here the District Director, Internal Revenue) to grant an award 'as he may deem necessary' and 'as he deems suitable' for information that leads to detection and punishment of revenue law violations.

"The Administrative Procedure Act is not a jurisdictional statute but merely outlines procedures for judicial review of administrative action. Here, plaintiff is not entitled to review because such review is excluded where 'agency action is committed to agency discretion by law.' 5 U.S.C. § 701(a)(2). This court has no jurisdiction to grant the relief requested. The sovereign has not consented to be sued on a claim of this kind. The claim was made to the District Director and rejected. We have no power to inquire into his use of discretion given to him exclusively by law. Plaintiff has not met his burden of showing that the District Director's action has no reasonable basis. Additionally, the court notes that similar petitions to the one before us were dismissed by the United

States District Court of New Jersey on October 9, 1974, and January 27, 1975, so that the present claim is *res judicata.*

"IT IS THEREFORE ORDERED that upon consideration of defendant's motion to dismiss, the statutes and regulation cited above, upon authority of *Saracena* v. *United States*, 206 Ct. Cl. 90, 508 F. 2d 1333 (1975), without oral argument, and for the reasons herein stated, the motion to dismiss is granted. The petition is dismissed."

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NOS. 29-75 AND 77-75. JUNE 20, 1975

Joseph L. Bilka

*Military pay; retired pay (nondisability); computation of pay; adjustment to reflect changes in Consumer Price Index.*—On June 20, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"These consolidated claims by the same plaintiff are before the court on plaintiff's motion for judgment and defendant's cross-motion for summary judgment. Plaintiff, a retired Navy Commander, alleges that the Department of the Navy, relying on two decisions of the Comptroller General of March 25, 1974, 53 Comp. Gen. 701; 53 Comp. Gen. 698, did not comply with 10 U.S.C. § 1401a(e) in computing his retired pay. Plaintiff claims some $46.51 per month more than he has been awarded. The problem seems to have arisen because basic pay increases have not kept pace with consumer price increases which are added to retired pay, making it more profitable, in some instances, to have retired earlier even though at a lower basic pay. In the aforesaid decisions of the Comptroller General, however, he explicitly rejected the concept that it was allowable as a matter of law to compute retirement on an earlier base year in the manner plaintiff attempts. In plaintiff's own case he stated in a letter to plaintiff on September 20, 1974, in part:

> In the March 25 decisions, * * * we gave careful consideration to the language, purpose and legislative history of 10 U.S.C. 1401a(e) and we held that in the absence of specific language in the statute or its legislative history to the contrary, the floor provided by 10 U.S.C.

> 1401a(e) must be limited to the rate of pay in effect on the day before the effective date of the rate of monthly basic pay on which the member's retired pay would otherwise be based, plus appropriate Consumer Price Index increases from that date forward. That is, under those decisions, a member's retired pay is to be computed by two methods, (1) based on the active duty pay rate in effect at the time of his retirement and, (2) based on the immediately prior active duty pay rate, plus any appropriate Consumer Price Index increases which became effective subsequent to that prior active duty pay rate and before the actual date of the member's retirement, whichever method produces the greater amount of retired pay. Further, the computation of retired pay may not be based on any active duty pay rates which were in effect prior to the rates of pay used in method (2), even though in some cases such computation (which would include all Consumer Price Index increases which became effective between that earlier date and the date of the member's actual retirement) would produce a greater retired pay benefit than the higher of the beforementioned methods of computation.
>
> It appears that legislation would be required to change these methods of computation.

"The court has carefully considered plaintiff's attack on the decisions of the Comptroller General, the Department of Defense papers submitted for our consideration, and has considered all other papers accompanying the pleadings and motions, and plaintiff's stout insistence that the legislative history of the statute shows congressional intent to prevent later retirement with less real pay. However, we are not persuaded upon consideration of plaintiff's effectively presented arguments that he is correct as a matter of law and that the Comptroller General and the Department of the Navy are incorrect in their computations and method of applying the statute. If there are any changes to be made in it to reflect an intent contrary to what we believe it means or to alleviate alleged inequities arising from the inflationary factor and delays in the increase of basic pay, legislation would be required.

"IT IS THEREFORE ORDERED that upon consideration of all the papers in the case, without oral argument, plaintiff's motion for judgment is denied. Defendant's cross-motion for summary judgment is granted. The petitions are dismissed."

No. 16–74. JUNE 25, 1975

Lois H. Mitchell

*Civilian pay; adverse personnel action; charges and reasons for action; due process.*—On June 25, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, MARKEY, *Chief Judge**, and LARAMORE, *Senior Judge.*

"This case comes before the court on plaintiff's motion for summary judgment and defendant's cross motion for summary judgment. Upon consideration of the motions of the parties, after hearing oral argument, and after reviewing the lengthy administrative record in this case, the court finds:

"(1) The Civil Service Commission correctly concluded that the adverse action against plaintiff was accomplished by compliance with the applicable statute (5 U.S.C. § 7501) and the governing regulations (5 C.F.R. § 752.202 and FPM Supplement 752–1, 54–1(2)). The regulations required only that the agency assemble and make available to plaintiff the material on which the notice of the proposed adverse action was based and which was relied on to support the charges. The material, which defendant relied on and upon which the notice was based, was assembled and made available to the plaintiff; it consisted of approximately 400 pages. In the oral reply to the charges, plaintiff acknowledged that the notice of adverse action was not based on the control cards or the cases processed by plaintiff. The failure to furnish the cases and control cards to plaintiff was not a violation of the regulations.

"(2) The charges set forth in the notice to plaintiff were sufficiently specific and detailed to meet the requirements of 5 C.F.R. § 752.202(a)(1). *See Burkett* v. *United States*, 185 Ct. Cl. 631, 402 F.2d 1002 (1968). The administrative finding that plaintiff sufficiently understood the charges to afford her a fair opportunity to present her defense against the reasons given for the proposed action is supported by substantial evidence. *See Schlegel* v. *United States*, 189 Ct.

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*Chief Judge of the United States Court of Customs and Patent Appeals, sitting by designation pursuant to 28 U.S.C. § 293(a).

Cl. 30, 416 F.2d 1372 (1969), *cert. denied*, 397 U.S. 1039 (1970). The record shows that plaintiff's oral reply to the charges when transcribed consisted of 60 pages of typewritten matter, and she offered a large number of documentary exhibits.

"(3) The findings of the Civil Service Commission that the agency used the same standards for measuring plaintiff's performance as were used for other examiners; that plaintiff was advised of the standards, and that they were not unreasonable are supported by substantial evidence. The record shows that the standards were set forth in three warning notices of inefficiency and in a progress report which were sent to plaintiff before the adverse action was taken.

"(4) Although the evidence was conflicting on many of the factual issues, there is substantial support in the evidence for the findings of the Civil Service Commission that the proof sustained the charges that plaintiff had failed to meet acceptable production requirements and that her error rate was in excess of acceptable quality requirements. The administrative finding that the evidence which plaintiff offered in mitigation of the charges was not sufficient to justify her failure to meet acceptable standards is also supported by substantial evidence.

"(5) The Regional Office, as well as the Board of Appeals and Review of the Civil Service Commission, found that the agency's failure to provide plaintiff access to the cases and control cards did not prevent or deny her the right to adequately refute the charges in her oral reply or at the Regional Office hearing. In view of plaintiff's participation in the review of errors assigned to her, her extensive oral reply, the evidence she adduced at the hearing, and the record as a whole, the administrative findings are supported by substantial evidence. Under the guidelines laid down by the Supreme Court in *Arnett* v. *Kennedy*, 416 U.S. 134 (1974), the proceedings under which plaintiff's demotion was effected complied with the due process requirements of the Fifth Amendment.

"Based on the foregoing, the court concludes:

"(A) Plaintiff was accorded the rights granted to her by the statute and the administrative regulations.

"(B) The decision of the Civil Service Commission is supported by substantial evidence and is neither arbitrary nor capricious.

"(C) In the proceedings leading to her demotion, plaintiff was accorded due process, and there was no violation of her Constitutional rights.

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment is denied, defendant's motion for summary judgment is granted, and plaintiff's petition is dismissed."

Petition for certiorari was denied January 12, 1976, 423 U.S. 1049.

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No. 292-69. JUNE 27, 1975

Emil W. Kaeserman

*Military pay; correction of military records; active duty credit; use by Board of ex parte medical report.*—On June 27, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*. KUNZIG, *Judge*, concurs in the result.

"This case was originally briefed and argued before the full court on cross motions for summary judgment. By order dated June 1, 1973, the court with three judges dissenting, remanded the case to the Army Board for Correction of Military Records (ABCMR), 202 Ct. Cl. 1081. The suit is for commissioned officer's pay during a period of years when the plaintiff actually was employed as an enlisted man, having been rejected for return to active duty in the reserve officer rank he held. The circumstances included a 1947 diagnosis of plaintiff as suffering from herniated nucleus pulposus, which the Surgeon General in 1965 held was and had been erroneous. This diagnosis did not disqualify plaintiff from active duty as an enlisted man but for reasons not fully or at all explained, did disqualify him as an officer in a rank he had previously held. See the prior order for further details. The remand did not dispose of the motions, and such disposal is now possible. The parties have filed supplemental briefs and argued the case orally before this panel. Since the oral argument plaintiff has filed a motion, which we have allowed, for leave to file another supplemental brief and such further brief has been considered.

"The ABCMR took the case as directed and granted plaintiff a hearing. It obtained *ex parte* a further report from the Surgeon General. In light of that further report, it is not as clear as it previously appeared that the disqualification decisions of 1948 and later relating to plaintiff's physical fitness for active duty as an officer were in error. The ABCMR finds in effect they were correct. The plaintiff, taking the opposite side of the coin, also contended to the ABCMR that when retired he was disabled and should have received a disability retirement as a Colonel.

"As we read the ABCMR, even if the medical evidence in the case were unchanged from when it was before us previously, it would be impossible because too speculative to postulate a constructive active duty credit as an officer for this plaintiff from 1948 to 1966. This is what we wanted the Board to determine. Though 3d Army apparently wanted plaintiff on active duty with it, the Board says there was little need to recall officers of his specialty in 1948 when he applied. We must presume this statement is based on fact and is not a fabrication. If there was a need in 1950, the Korean war period, it would be impossible to say how long plaintiff would have served or what rank he would have attained. There is no way we can say the Board was arbitrary and capricious in drawing this conclusion as to a matter within its expertise. Assuming the Board to be unwilling to exercise its discretion favorably in the premises, there is no way this court can constructively and retroactively order active duty or promotions in rank. *Abruzzo* v. *United States*, 206 Ct. Cl. 731, 513 F. 2d 608 (1975). If the discretion were ours, how we would exercise it is not for consideration here.

"The claim that plaintiff was disabled on retirement in 1966 was apparently an attempt to exploit plaintiff's repeated rejections on physical grounds as a kind of estoppel. Plaintiff applied for retirement on longevity grounds and a medical Board at that time found he was fit for further active duty. We do not think the ABCMR was arbitrary and capricious in denying a disability retirement, especially since plaintiff linked this claim, inextricably so far as the ABCMR decision reveals, with the contention he should have been retired as a Colonel. The rank at retirement and the character of retirement are logically two distinct issues, but if the applicant for relief links them together as one, the ABCMR is not arbitrary and capricious in doing the same.

"We do not think the ABCMR committed any error reversible by us in obtaining *ex parte* a further medical report from the Surgeon General, for use in considering plaintiff's requests for discretionary relief. *Merson* v. *United States*, 173 Ct. Cl. 92, 97–98 (1965).

"The 1973 order in this case anticipated *Testan* v. *United States*, 205 Ct. Cl. 330, 499 F. 2d 690 (1974), *cert. granted*, 420 U.S. 923 (1975), in holding that under authority of Pub. L. 92–415 amending 28 U.S.C. § 1491, we could remand a case to an administrative body for consideration or reconsideration of relief we could not ourselves directly grant because essentially discretionary, when a favorable decision below would generate a valid money claim. Pending the outcome of *Testan*, in the Supreme Court, this order is not to be read as affirming or disaffirming our belief in the existence of such power.

"In view of the foregoing, plaintiff's motion for summary judgment is denied, defendant's motion for summary judgment is granted, and the petition is dismissed."

On October 30, 1975 plaintiff's motion for rehearing to alter judgment was denied. Plaintiff's *petition* for *certiorari* was denied January 12, 1976, 423 U.S. 1050.

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No. 520-69. JUNE 27, 1975

Cetron Electronic Corporation, a Delaware corporation, and Emil Makar

*Pleading and practice; discovery and inspection; production of documents; relevance; privilege; Freedom of Information Act.*—On June 27, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This case is before the court on defendant's motion for review, pursuant to Rule 53(c)(2)(ii), of an order of Trial Judge Harkins, filed December 4, 1974, allowing plaintiffs' motion under Rule 74 for production and inspection of seven Internal Revenue Service (IRS) documents, and the trial judge's order filed March 14, 1975, denying defendant's motion for reconsideration of the order of December 4, 1974. Defendant also challenges the trial judge's refusal to certify this matter, pursuant to Rule 53, to the court for review as a matter of controlling importance or deprivation of rights which must have a final ruling prior to decision on the merits. We believe that defendant has made a sufficient showing to permit review.

"Defendant says that, if the trial judge would not deny discovery of the documents to plaintiff, he should have at least agreed to an *in camera* examination thereof for the purpose of excising privileged and irrelevant portions pertaining to advisory opinions as contrasted to factual matters. Defendant says that the advisory opinions of IRS officials are here exempt from disclosure on the grounds of relevancy, failure to show good cause, and so-called 'governmental privilege,' as contrasted to executive privilege.

"This case involves the question of whether the plaintiffs are liable for the failure of Associated Engineers, Inc. (Associated Engineers), a defunct wholly owned subsidiary, to withhold and pay over to IRS federal employment taxes for the second and third calendar quarters of 1963. Plaintiff Makar is president of Cetron Electronic Corporation. Third-party plaintiffs include a former president of Cetron during the quarterly periods in issue, who was also a director of Associated Engineers at the time, together with the Cetron treasurer who was also a director of both corporations. IRS made a 100-percent penalty tax assessment against all plaintiffs. Token payments were made and refund claims were made and denied. The plaintiffs seek a refund of the taxes paid, and defendant's counterclaim seeks recovery of the unpaid assessments. The seven contested documents (group II documents) are what remain of many documents otherwise discovered, voluntarily or by order. The contested documents were prepared during the period from April 15, 1966 through February 7, 1969. They consist of internal reports of officials of IRS relating to assessment of the 100-percent penalty tax under section 6672 of the Internal Revenue Code of 1954, against those persons deemed responsible for the failure of Associated Engineers to collect and pay over to IRS the taxes at issue.

### RELEVANCE

"As the trial judge properly pointed out, the Rules of the Court of Claims provide for discovery upon motion showing 'good cause' (Rule 71(a)) when the materials sought are 'not privileged' (Rules 71(b)(1) and 74(b)(1)) and when they are 'relevant' (*id.*) to the subject matter involved in the pending action. It is not ground for objection that the information sought may be inadmissible at the trial if it appears reasonably calculated to lead to the discovery of admissible evidence (Rules 71(b)(1) and 74(c)).

"The documents described above plainly relate to the assessment of the taxes involved and to the issues in this case. Plaintiffs assert a need for these materials in order to identify the scope of a stipulation defendant agreed to in bankruptcy proceedings of Associated Engineers. They may lead to admissible evidence. Plaintiffs say that the only source of information presently available are the records of defendant since the bankruptcy records have not been located. Plaintiffs also want to know about defendant's other efforts to collect the taxes due and assessed here and about its efforts to recover from agencies of the United States amounts they owed the bankrupt under contracts with it.

"Defendant objects that the records contain opinions, reasoning, and conclusions of officials of IRS evaluating the penalty assessment made and the responsibility for payment and, while they do relate to the assessment of the taxes involved, they are not probative evidence on the issues in the refund case, and therefore not fully relevant. Defendant believes all the basic, relevant, transactional facts are known to plaintiffs already and relies on cases we believe not to be helpful to its position. One of these is *Gay Gibson, Inc.* v. *United States*, 198 Ct. Cl. 993 (1972). In that case plaintiff also sought certain intra-agency documents, and the court's order on request for review remanded the problem to the trial judge for an *in camera* inspection of the questioned documents to excise advisory opinions, conclusions and reasoning of Government officials in the administrative and decision-making process and required, further, that if these things were so intertwined with factual matters that they could not be separated, production then should be denied. *Gay Gibson* was the taxpayer, unlike here, where our plaintiffs presumably have less or no knowledge of what occurred within the IRS. In the cited case, the basis for the deficiency assessment was alleged unreasonable compensation to the executive officers. The court issued its order without oral argument. We do not know whether it may have concluded that the material there sought was simply not subject to discovery because irrelevant. There was no discussion of the facts. In any event, the parties in the present case have well briefed the matter, and the trial judge has filed two well-prepared opinions on the issues—none of which were available to us in *Gay Gibson*. We are satisfied that relevance has been demonstrated here. We do not, at this stage of the proceedings, have to consider how probative the evidence may be or whether it is admissible at trial. Under the circumstances, the *Gay Gibson* order, which is terse and without citations, is of limited precedential value in the present case. The other cases cited by defendant are inapposite.

### GOOD CAUSE

"Determination of good cause turns on the facts of each case and must be decided within the discretion of the trial judge. 4A MOORE'S FEDERAL PRACTICE ¶ 34.08 (2d ed. 1974); 2A BARRON AND HOLTZOFF, FEDERAL PRACTICE & PROCEDURE § 796 (Rules ed. 1961). Here he has concluded that the facts show production is necessary, that there is a demonstrated, genuine need for the documents, that they are in defendant's exclusive custody, that the trial cannot continue until the matter now contested is resolved, and that plaintiffs' demand is not an idle fishing expedition. If relevant, genuinely needed, and not otherwise available, there is good cause for production of documents for trial preparation. In the spirit of our Rule 1, we give a liberal construction to the application of the rules to afford an expeditious and just determination of actions. *Cf.* Rules 71 and 74 and Fed. R. Civ. P. 26 and 34 and advisor's notes. *American Cyanamid Co.* v. *Hercules Powder Co.*, 211 F. Supp. 85, 90 (D. Del. 1962).

### 'GOVERNMENTAL PRIVILEGE'

"Defendant's principal contention is that the seven group II documents are privileged from production under Rule 74 because of an alleged general privilege the Government has against disclosure of any intra-agency communications that contain opinions, conclusions, and reasoning of Government officials used in the administrative decision-making process. Defendant seeks to distinguish and does not assert the doctrine of executive privilege which can be personally invoked only by the head of a department or agency. Both doctrines are said to have a similar basis, however, in public policy which favors candid discussion between subordinates and superiors in Government. It is argued that such discussion would be handicapped by the possibility of disclosure and, thus, the decisionmaking process would be impeded. There is, however, also a general public policy for production of evidence needed in the search for truth. In the adversary system of establishing truth by litigation, this is very important, for such a system requires development of all relevant facts to produce real justice through due process. These competing considerations were fully developed by the orders of the trial judge on December 4, 1974, and March 14, 1975. He concluded that—

> Unless there is a valid executive privilege, properly asserted, no public policy countenances withholding relevant information needed in the judicial process for evidentiary purposes merely because one of the contesting parties is the Government. The Government, as a litigant, has no greater right to secrecy in a tax refund case than a private litigant. Intra-agency communications, if relevant and not privileged, are subject to discovery. [Footnote omitted.]

There is no attorney-client privilege claimed here or any claim of privilege for an attorney work product. The trial judge on *in camera* inspection denied discovery as to such matters. There is no military or diplomatic secret sought to be protected. There is no effort to get a private ruling or memoranda in some unrelated taxpayer's file. There is only a claim for production of documents routinely prepared in the day-to-day activities of the IRS relevant to the assessment against plaintiffs. There is no showing that their production would upset vital Government functions—for there is no claim of executive privilege. We are not persuaded that disclosure here will have any significant or adverse effect on the caliber of IRS decisions. The broad, general privilege asserted by defendant does not exist apart from executive privilege. When relevance and good cause for disclosure is shown and a recognized privilege is not claimed, disclosure is mandated by the rules in a suit against the United States. Rule 501 of the Uniform Federal Rules of Evidence provides in pertinent part that—

> Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience. * * *

There is no common-law privilege of the general nature asserted by defendant here. The common law speaks only of executive privilege and of such things as attorney-client, husband-wife, and priest-penitent privilege. *Cf. Kaiser Alum, & Chem. Corp.* v. *United States*, 141 Ct. Cl. 38, 45, 157 F. Supp. 939, 944 (1958). Further, it is clear from the legislative history of the Federal Rules of Evidence that Congress rejected the concept of governmental privilege against disclosure of official information in favor of the general reference in Rule 501 to those privileges recognized by the Constitution, statute, and the common law. [See annotations to Rule 501 and to proposed Rule 509 rejected by Congress.]

"Defendant points to the Freedom of Information Act, 5 U.S.C. § 552, and to exemption 5 found in section 552(b)(5) as statutory authority for its position. The FOIA was designed to make Government documents more freely available to an inquiring public, with certain specified exceptions. *Soucie* v. *David*, 448 F. 2d 1067 (D.C. Cir. 1971). Exemption 5 is one of those exceptions and as interpreted by the courts protects, against disclosure, internal working papers in which opinions are expressed and policies are formulated and recommended short of the final decision. Again, the purpose of that exemption is to encourage candid expression of views by subordinates to the decision makers of Government. Advice memoranda that explain final decisions are outside the scope of exemption 5 and must be disclosed. Two recent Supreme Court cases have delineated the application of this exemption. *NLRB* v. *Sears, Roebuck & Co.*, 421 U.S. 132 (1975), and *Renegotiation Bd.* v. *Grumman Aircraft Eng'r Corp.*, 421 U.S. 168 (1975). In exercising equity jurisdiction conferred by the FOIA, the appropriate court must weigh effects of disclosure and nondisclosure, according to traditional equity principles, and determine the best course to follow in given circumstances, and in making such determination effect on the public is the primary consideration. *General Serv. Adm.* v. *Benson*, 415 F. 2d 878 (9th Cir. 1969). The clear trend of decision in such cases, as reflected by recent FOIA amendments, is to favor disclosure.

Defendant, however, fails to distinguish between the policies and purposes of the FOIA and the discovery rules of the court. The FOIA does not establish a privilege against disclosure that may be asserted by counsel under Rule 74. The ROIA is enforced exclusively by federal district courts, and the Court of Claims has no jurisdiction thereunder. Further, '[d]iscovery for litigation purposes is not an expressly indicated purpose of the Act.' *Renegotiation Bd.* v. *Bannercraft Clothing Co.*, 415 U.S. 1, 20, 24 (1974).

Finally, defendant says that to require production of the documents as to which discovery is here sought would conflict with *Gay Gibson, supra.* The short answer to that is that the brief order in *Gibson* did not discuss the issue of governmental privilege, independent of executive privilege. Defendant argues only that the order 'impliedly acknowledged the existence of such privilege.' We do not think so. While the order protected intra-agency opinions and conclusions against disclosure, we are not shown that executive privilege was not the basis for the ruling or was not claimed. We do know that the factual context from which that order arose was materially different from the facts of this case.

"We believe the weight of modern authority is expressed in *Peterson* v. *United States*, 52 F.R.D. 317 (S.D. Ill. 1971), and *Abel Investment Co.* v. *United States*, 53 F.R.D. 485 (D. Neb. 1971). They hold that free discovery of materials which are not trial preparation materials or otherwise privileged is favored under the Federal Rules of Civil Procedure. Our rules are similar and mandate a similar result. These were tax refund cases. They say that mere presence of opinions, conclusions and recommendations, not trial preparation material, is no protection against discovery when relevance and a genuine need is shown for their discovery. That is the case here. Counsel for the Government should not be permitted to determine what evidence the court will permit to be discovered by exercise of such a unique pretext as it now advances. Governmental interests are protected by constitutionally recognized common-law executive privilege, properly asserted. Of course, even executive privilege has its limitations and is not absolute, but we do not need to go into that here since it is not claimed in this case. *United States* v. *Nixon*, 418 U.S. 683 (1974), *Sun Oil Co.* v. *United States*, 206 Ct. Cl. 742, 514 F. 2d 1020 (1975).

"IT IS THEREFORE ORDERED that, upon review, defendant's objections to the orders of the trial judge of December 4, 1974, and March 14, 1975, must be and are rejected, and the defendant's motion for relief thereunder is denied. The orders are affirmed."

On October 3, 1975 the court denied defendant's motion for rehearing and rehearing *en banc*.

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No. 85-72. JUNE 27, 1975

National Life Insurance Co.

*Taxes; income tax; life insurance companies; investment credit; assets; escrow funds for payment of taxes, insurance* *premiums, etc.*—On June 27, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges.*

"This case comes before this court on plaintiff's motion for summary judgment and defendant's cross motion for summary judgment. We find that the material facts are not in dispute. The question involved here is whether the escrow funds which plaintiff and the plaintiff's independent mortgage loan correspondents maintained in segregated bank accounts on behalf of plaintiff for the sole purpose of making payments of the mortgagor's taxes, fire and other hazard insurance premiums, and FHA insurance premiums are assets 'of the company' or 'of the life insurance company' within the meaning of Section 805(b)(4) of the Internal Revenue Code of 1954 and the Regulations. The plaintiff maintains that these escrow funds are *not* assets 'of the company.' The defendant maintains that these escrow funds are plaintiff's assets 'of the company.'

"The question has been decided against the Government in the following cases: *Franklin Life Insurance Co.* v. *United States*, 67-2 USTC ¶9515, 19 AFTR 2d 1734 (S.D. Ill. 1967), the Government did not appeal the mortgage escrow funds as assets issue; *Jefferson Standard Life Insurance Co.* v. *United States*, 272 F. Supp. 97 (M.D.N.C. 1967), *aff'd* and *rev'd*, 408 F. 2d 842 (4th Cir.) *cert. denied*, 396 U.S. 828 (1969), the Government again did not appeal the escrow funds issue; *Liberty National Life Insurance Co.* v. *United States*, 463 F. 2d 1027 (5th Cir. 1972), the Government appealed the issue here but lost; *Bankers Union Life Insurance Co.*, 62 T. C. 661 (1974). In each of the four cases above mentioned, the court has concluded that mortgage escrow funds which are held in behalf of the mortgages do not constitute assets of the life insurance company for purposes of Section 805(b)(4) above mentioned. We are in accord with the views expressed in said decisions.

"The various reasons defendant claims as new grounds not presented in the four cases above mentioned are tenuous. The benefit referred to in the *Liberty National* and *Bankers*

*Union* cases which could result in an asset determination was the freeing up of other assets for investment, not the alleged benefits referred to by the defendant in the instant case. The benefit of a smaller servicing fee by mortgage loan correspondents is speculative and if existing, not sufficient reason to hold the escrow funds to be assets. The FHA mortgage insurance premium matter was involved in *Jefferson Standard Life Insurance Co.* v. *United States*, *supra* at 119–20. We are not persuaded by defendant's new reasons.

"We hold in favor of the plaintiff and allow its motion for summary judgment on the grounds that plaintiff's "assets" as defined in Section 805(b)(4) aforesaid are properly computed without including any of the special escrow funds deposited with the plaintiff or with plaintiff's mortgage loan correspondents by mortgagors for the payment of their taxes, fire and other hazard insurance premiums, and FHA insurance premiums. Defendant's motion for summary judgment is denied."

On February 6, 1976 the court issued an order, in response to plaintiff's motion for amendment of the judgment entered in the above order, vacating the said judgment in the amounts stated, and substituting the following:

"IT IS FURTHER ORDERED that judgment be and the same is hereby entered for plaintiff in the sum of $110,344 as refund of taxes and $49,086 as refund of assessed interest, together with statutory interest thereon, broken down for the years involved as follows:

| *Year* | *Refund of taxes* | *Refund of Assessed Interest* | *Total Refund* |
|---|---|---|---|
| 1958 | $26, 007 | $12, 976 | $38, 983 |
| 1959 | 27, 015 | 12, 669 | 39, 684 |
| 1960 | 57, 322 | 23, 441 | 80, 763 |
| | $110, 344 | $49, 086 | $159, 430 |

"IT IS FURTHER ORDERED that plaintiff's attorney shall return to the Clerk of this court the transcript of judgment entered June 27, 1975, before a transcript of judgment for plaintiff shall be issued on this order."

No. 166–73. June 27, 1975

Ardelt-Horn Construction Co.

*Contracts; interpretation; default termination; notice of delays and changes; Government waiver of lack of notice; compliance with specifications.*—On November 8, 1974 Trial Judge C. Murray Bernhardt filed a recommended decision (reported in full at 21 CCF para. 84096) in the above-identified case, in which plaintiff whose contract was default terminated seeks review of the decision of the Armed Services Board of Contract Appeals (73–1 BCA para. 9901). The trial judge concluded that the Board's decision as to each of the separate items of claim by plaintiff is not arbitrary, capricious and is supported by substantial evidence, except that the Board decision of a time extension of 10 days for excusable delay is not supported by substantial evidence, whereas a more plausible computation is 16 days. This case came before the court (COWEN, *Chief Judge*, DURFEE, *Senior Judge* and SKELTON, *Judge*) on plaintiff's request for review and defendant's request for partial review of the recommended decision, on the parties' motions for summary judgment, having been submitted on the briefs and oral argument of counsel. Since the court agrees with the recommended decision, on June 27, 1975 the court affirmed and adopted the decision as the basis for its judgment in this case, concluded that the default termination was justified and dismissed the petition.

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No. 240–73. JUNE 27, 1975

Atlantic Gulf & Pacific Co. of Manila, Inc.

*Contracts; authority of contracting officer; settlement agreement.*—On June 27, 1975 the court issued the following order:

Before KASHIWA, *Judge*, Presiding, LARAMORE, *Senior Judge, and* BENNETT, *Judge*.

"This case is before this court on plaintiff's 'Motion for Summary Judgment on Count One of Petition,' filed February 14, 1974, and defendant's cross motion for summary judgment on Count One, filed May 17, 1974. Material facts for both motions are admitted and not in dispute.

"Plaintiff's Count One allegations seek to establish a claim based upon a termination settlement negotiated between plaintiff and the termination contracting officer (hereinafter "TCO") in the amount of $563,331, which was unanimously disapproved by the Headquarters Air Force Logistics Command Settlement Review Board. Plaintiff's motion for summary judgment is limited to the issue of the efficacy of the settlement agreement negotiated by the TCO and plaintiff's representatives.

"Plaintiff seeks review, under Wunderlich Act[1] standards, of the Armed Services Board of Contract Appeals (hereinafter 'ASBCA' or 'Board') determination that the TCO did not have authority to enter into a binding settlement agreement in excess of $50,000 without approval of the Settlement Review Board.

"It is the Government's position under its cross-motion for summary judgment on Count One that the determination by the Board was correct that the TCO did not have the requisite authority to enter into a binding settlement and that the Government is not estopped to disavow the illegal, ultra vires acts of its agents.

"Defendant's cross-motion for summary judgment on Count One is granted and plaintiff's motion for summary judgment on Count One is denied for the reasons hereinafter stated. Since the settlement negotiated by the TCO exceeded $50,000, ASPR § 8.211-2 clearly applies; and such Government officer was required by its terms to submit such settlement for approval by a Settlement Review Board, ASPR § 8.211-2(a)(1), *prior* to executing any settlement agreement. Federal departmental regulations have the force and effect of law and are 'binding on all who [seek] to come' to contract with the Government. *Federal Crop Insurance Corp.* v. *Merrill*, 332 U.S. 380, 385 (1947). *Winston Bros. Co.* v. *United States*, 198 Ct. Cl. 37, 44, 458 F. 2d 49, 52-53 (1972). When the regulations are published and made known to the public in the Federal Register, they are binding for purposes of notice of an agent's authority and any restrictions of that authority. *Federal Crop Insurance Co.* v. *Merrill*, *supra* at 384–85, and cases therein cited; *Schoenbrod* v. *United States*, 187 Ct. Cl. 627, 634, 410 F. 2d 400, 403–404 (1969); *Prestex Inc.* v. *United States*, 162 Ct. Cl. 620, 625, 320 F. 2d 367, 371 (1963). An agent must act within the scope of his actual authority in order for his acts to bind the Government. *Federal Crop Insurance Corp.* v. *Merrill*, *supra; Nuss* v. *United States*, 127 Ct. Cl. 197, 206–207, 117 F. Supp. 413, 418–19 (1954). The Government is not estopped from denying the contested agreement's validity and binding effect. See *Putnam Mills Corp.* v. *United States*, 202 Ct. Cl. 1, 479 F. 2d 1334 (1973); *Emeco Industries, Inc.* v. *United States*, 202 Ct. Cl. 1006, 485 F. 2d 652 (1973); *Utah Power & Light Co.* v. *United States*, 243 U.S. 389 (1917).

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[1] 41 U.S.C. §§ 321, 322 (1970).

"In *L. B. Samford, Inc.* v. *United States*, 187 Ct. Cl. 714, 725, 410 F. 2d 782, 788 (1969), this court stated:

> * * * estoppel cannot be applied against the defendant on account of unauthorized statements or acts of an officer or employee who is without authority in his individual capacity to bind the defendant. * * *

"Furthermore, the ASBCA found that the TCO did not have the authority to enter into the agreement with plaintiff because it violated the regulation which was incorporated into the contract by reference. We determine that the Board's finding is supported by substantial evidence. This being a Wunderlich Act case, such findings are not to be disturbed. *Sea-Land Service, Inc.* v. *United States*, 204 Ct. Cl. 57, 493 F. 2d 1357 (1974); *Marley* v. *United States*, 191 Ct. Cl. 205, 423 F. 2d 324 (1970); *Dale Ingram, Inc.* v. *United States*, 201 Ct. Cl. 56, 475 F. 2d 1177 (1973); *Donald M. Drake Co.* v. *United States*, 194 Ct. Cl. 549, 439 F. 2d 169 (1971).

"It is, therefore, ordered that plaintiff's motion for summary judgment on Count One of the petition be and is hereby denied and defendant's cross motion for summary judgment on Count One be and is hereby allowed. Count One of plaintiff's petition is hereby dismissed."

No. 264-73. JUNE 27, 1975

Gerald J. Roseman

*Military pay; Court of Claims jurisdiction; lack of independent monetary claim; correction of military records; promotion; transfer to district court to cure defect of jurisdiction*—On June 27, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG and BENNETT, *Judges.*

"This military pay case comes before us on defendant's motion to dismiss plaintiff's petition for failure to state a claim upon which relief can be granted.

"Plaintiff, a Major in the Air Force, brings this action under the Tucker Act, 28 U.S.C. § 1491, as amended (Supp. II, 1972), seeking a retroactive promotion to the rank of Lt. Colonel, effective April 22, 1974, with corresponding back pay and correction of his military records. Additionally, plaintiff seeks correction of his military records to reflect a previously granted promotion to the rank of Major, effective November 11, 1967.

"Upon consideration of defendant's memorandum in support of its motion, plaintiff's memorandum in opposition and without oral argument, we conclude plaintiff has failed to state a claim within the jurisdiction of this court.

"An absolute prerequisite to our jurisdiction is a claim for a money judgment presently due. *United States* v. *King*, 395 U.S. 1 (1969); *Kirby* v. *United States*, 201 Ct. Cl. 527, 537 (1973), *cert. denied*, 417 U.S. 919 (1974). While plaintiff has proposed a novel twist, his failure to present an independent monetary claim is fatal to his case. The only potential claim for a money judgment presented in plaintiff's petition is retroactive pay in the rank of Lt. Colonel. This back pay claim is contingent on our first ordering plaintiff's promotion in a case where the promotion is within the discretionary zone. We have held that this court is not in the promotion business. *Yee* v. *United States*, 206 Ct. Cl. 388, 512 F.2d 1383 (1975). But even if we were in the 'promotion business,' such relief could only be granted incidental to, and not independent of, a monetary judgment.

"Since plaintiff has not presented an independent monetary claim upon which this court can grant relief, his request for correction of his military records must likewise be dismissed. Although Pub. L. 92–415 would permit this court to order the correction of military records incidental to the award of a money judgment, this statute does not provide an independent jurisdictional basis.

"In his opposition to the present motion, plaintiff has asked us to transfer his case to a United States District Court under our 28 U.S.C. § 1506 transfer power in the event we find our jurisdiction wanting. We deny this request.

"Our § 1506 transfer authority exists in situations where we find the claim presented to be in the exclusive jurisdiction of a United States District Court. Plaintiff's case, as pleaded, is not within the exclusive jurisdiction of the District Court. Plaintiff's petition names the United States as defendant. Under such caption, the District Court's jurisdiction, if any, would be concurrent with ours, under the Tucker Act, but not exclusive.

"IT IS THEREFORE ORDERED defendant's motion to dismiss is granted and the petition is dismissed. Plaintiff's request for transfer under 28 U.S.C. § 1506 is denied."

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**No. 86–74. June 27, 1975**

Rex L. Applegate, et al.

*Civilian pay; promotions; freeze on promotions.*—On June 27, 1975 the court issued the following order:

Before KASHIWA, *Judge*, Presiding, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

"This civilian pay case is before the court on cross-motions for summary judgment. Plaintiffs are employees of the United States Customs Service (formerly the Bureau of Customs, Department of the Treasury). Their employment at the Bureau of Customs began in the early Winter of 1971, when they were appointed as trainees at the GS–7 level. The Standard Form 50, 'Notification of Personnel

Action,' received by each plaintiff at the time of appointment, contains the following language:

> Trainee to journeyman promotion to GS-9 due [1 year from commencement of employment] providing all requirements are met.

Plaintiffs also received oral assurances of promotion similar to the above-written language.

"On December 11, 1972, the President of the United States ordered a freeze on, *inter alia*, virtually all promotions of Federal civilian employees. The freeze was lifted for Bureau of Customs employees on March 4, 1973, and plaintiffs were thereafter promoted to grade GS-9. The net result of the freeze was a delay of 2 to 3 months in the promotions anticipated for government. Assuming, without deciding, that arbitrary and capricious action by the OMB would be the basis for an action in this court, we conclude that the OMB's action was neither arbitrary nor capricious. The OMB could reasonably conclude that plaintiffs' promotions were not essential to protect property or to preserve the continuity of government. In addition, the OMB's action was consistent with guidelines prepared by the Civil Service Commission, which guidelines did not recognize "career program, career ladder, or similar promotion patterns" to constitute valid exceptions to the freeze.

"IT IS THEREFORE ORDERED, upon consideration of the arguments made by the parties both in briefs and orally, that plaintiffs' motion for summary judgment be and the same is hereby denied, and defendant's cross-motion for summary judgment is granted. Plaintiffs' petition is dismissed."

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NO. 87-74. JUNE 27, 1975

Confederated Salish and Kootenai Tribes of the Flathead Reservation, Montana

*Indian claims; fiduciary obligation of Government as trustee of Indian property; summary judgment, when appropriate.*—On June 27, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and BENNETT, *Judges*.

"This case comes before the court on plaintiff's motion for summary judgment, filed October 22, 1974, and defendant's cross-motion for summary judgment, filed January 6, 1975. The motions were submitted on the briefs, without oral argument of counsel. The record is brief. It is made up of only the pleadings and the respective motions with brief attachments to said motions. Plaintiff's petition is for the return of the purchase price of $14,499.99 after its purchase of lands allotted to tribe member Florence Ellen Carlson Armstrong Henry Ragsdale ("Florence Carlson"), from the heirs of Florence Carlson, turned defective in that Florence Carlson, presumed dead under the Montana seven-year presumption statute, later turned up alive. The $14,499.99 was paid out of tribal funds in custody of the Bureau of Indian Affairs branch office at plaintiff's reservation.

"A major issue in the case is whether defendant as trustee of tribal funds did or did not exercise the standard of care required of such trustee under the rules expressed in *United States* v. *Mason*, 412 U.S. 391, 398 (1973). In light of plaintiff's argument by mere footnote reference to the following cases: Estate of Mabel Grace De Marsche, IA–D–25 (September 5, 1968); Estate of Es sun sey, IA–D–16 (December 21, 1967); Estate of Nanapa Coho, IA–1219 (May 14, 1966), as cases of similar nature where presumably deceased Indians reappeared alive, we are of the view that the circumstances in these instances may prove material in the degree of care required under *United States* v. *Mason*, *supra*. These are administrative decisions of the Department of the Interior and the records are not before us.

"The court is also of the view that the records in the two hearings before the Department of the Interior trial examiners, determining (1) that Florence Carlson was dead under the seven-year rule and (2) that she was not dead when she re-appeared, should be made a part of the record in this case. Furthermore, since the record at the present stage of the case is so sparse, both plaintiff and defendant should be permitted to fully develop their respective cases with relation to the standards set in *United States* v. *Mason*, *supra*.

"We hold that at this present stage of the record neither party shows that there is 'no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.' Rule 101(d).

"We conclude that both motions must be denied because there are material issues of fact to be determined and the record as presented is incomplete.

"Issues which may, therefore, arise at trial, *inter alia*, are: Whether defendant may be in breach of trust under the standards set in *United States* v. *Mason*, *supra;* and whether plaintiff-tribe is estopped under the circumstances to claim a breach of trust by defendant. Denial of both motions for summary judgment will leave plaintiff and defendant free to support their positions with evidence.

"It is, therefore, ORDERED that the parties' motions for summary judgment are hereby denied without prejudice; and the case is remanded to the trial division for trial or other appropriate disposition in conformity with this order."

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**No. 225-74. JUNE 27, 1975**

The American Ship Building Company

*Court of Claims jurisdiction; breach of contract claim* v. *tort claim.*—On June 27, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*. KUNZIG, *Judge*, concurs in the result.

"This case comes before the court on defendant's motion for summary judgment dismissing the action as a tort claim (not within the jurisdiction of this court under 28 U.S.C. § 1491), to dismiss for failure to exhaust administrative remedies, or else to suspend proceedings in the trial division pending administrative proceedings. After briefing and oral argument, we deny the motion on all grounds asserted.

"Plaintiff alleges breach by misrepresentation in award of plaintiff's June 8, 1966, contract with the Department of Commerce Maritime Administration, which called for construction of one oceanographic survey ship, named RESEARCHER. Among other allegations, plaintiff says defendant had 'special knowledge' that the mandatory terms of its bid solicitation were commercially impractical (*i. e.*, the ship could not be completed in 900 days, as contracted due to known technical difficulties), or for the price bid, which knowledge was derived by defendant from the failures and overruns associated with construction contracts of three similar earlier oceanographic vessels (SURVEYOR, contracted in 1957 to National Steel & Shipbuilding Co., completed in 3 years instead of 2; OCEANOGRAPHER and DISCOVERER, each contracted for in 1962 to Gibbs Shipyards but completed by Aerojet-General Corporation, in 4 years instead of 2; see *Aerojet-General Corp.* v. *United States*, 199 Ct. Cl. 422, 467 F. 2d 1293 (1972).) Defendant also prescribed an electronic automation system it allegedly knew had produced great difficulties in the earlier contracts by failures of the only known qualified subcontractor. Plaintiff claims damages of $5,402,450 losses, lost profits (unstated), and allowable interest in regard to its contract.

"Plaintiff claimed knowing misrepresentations, fraud, or deceit by defendant, but its answer to interrogatories do not reveal any, except that the contract requirement to complete the vessel in 900 days was a false representation she could be completed in that time, plaintiff says. Allegations by plaintiff of specific fraud and deceit practiced against it may be disregarded for the present in classifying the nature of the action here involved. Plaintiff and defendant dispute other critical issues, such as whether the scope of a 'release' of claims applies only to administrative claims previously settled or to the breach claims brought here. Defendant does not use this release as another ground for dismissal or summary judgment, however.

"The jurisprudence of this court has traditionally included breach claims of Government contractors who suffered losses in performance because of false information supplied by the Government or failure to divulge information the Government possessed and was under a duty to divulge, *e. g.*, *Hardeman-Monier-Hutcherson* v. *United States*, 198 Ct. Cl. 472, 458 F. 2d 1364 (1972); *Chris Berg, Inc.* v. *United States*, 186 Ct. Cl. 389, 404 F. 2d 364 (1968); *J. A. Jones Constr. Co.* v. *United States*, 182 Ct. Cl. 615, 390 F. 2d 886 (1968); *Helene Curtis Indus., Inc.* v. *United States*, 160 Ct. Cl. 437, 312 F. 2d 774 (1963). An action which arises primarily from a contractual undertaking is not barred because negligence by defendant gives the case also a tort aspect. *Bird & Sons, Inc.* v. *United States*, 190 Ct. Cl. 426, 420 F. 2d 1051 (1970). In view of this authority, we are not justified at this time in dismissing the action because of sounding in tort. If further evidence displays that it does sound primarily in tort, defendant can renew its motion and our order herein will be without prejudice to such renewal. It is also possible, of course, that the full facts will reveal no more than an imprudent bid. We are not holding at this time that the vague and general fact allegations now before us establish a breach of duty or do not; there is no motion before us requiring a holding on that.

"As regards the remainder of defendant's motion, defendant fails to establish that plaintiff has a contract remedy it should pursue. Defendant has cited to the court only two extracts from the contract: part of Article 4—'Changes in plans and specifications and adjustments of contract price for changes increasing or decreasing contract work' and Article 35, 'Disputes.' The disputes clause has to be read in light of other contract provisions providing remedies. Article 4 on its face applies only to CHANGES in plans and specifications—not to false representations or wrongful withholding of needed information. Defendant has simply failed to show an administrative contract remedy applicable to plaintiff's breach claims in this case. *National Steel & Shipbuilding Co.* v. *United States*, 190 Ct. Cl. 247, 419 F. 2d 863 (1969).

"Defendant makes much of plaintiff's petition allegation that the specifications were defective, and says that defective specifications are remediable under the 'Changes' article. We do not read plaintiff, however, as saying the specifications were defective in the ordinary sense, *i.e.*, if followed, a satisfactory product would not have resulted. They were defective only in the sense that they could not be fulfilled at the contract price, in the contract time. At any rate, we do not hold plaintiff will be able to recover in this suit any claims remediable under the contract, if it asserts any.

"Consequently, in light of the defendant's failure to show an applicable administrative contract remedy for a Board of Contract Appeals to apply, and also in light of past practice in similar cases of contract misrepresentation claims, *Aerojet*, *Berg* and *Helene Curtis*, all *supra*, defendant's motion to dismiss for failure to exhaust or to suspend proceedings pending further administrative proceedings is denied with prejudice. Defendant's motion for summary judgment is denied without prejudice so far as otherwise grounded, and this case is returned to the trial division for further proceedings."

Defendant's motion for rehearing was denied October 10, 1975.

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No. 249-74. JUNE 27, 1975

Edward E. Kaufman

*Civilian pay; probationary employee of Internal Revenue Service.*—On June 27, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, and KASHIWA, *Judge*.

"This case came before the court on defendant's motion for summary judgment and on May 1, 1975, this court ordered that any decision on that motion be suspended until plaintiff filed an answering brief within 30 days after May 1, 1975. Plaintiff has not filed his answering brief within the 30 days. Material facts are not in dispute.

"This court has held that employees outside of the competitive civil service have only those rights in a dismissal that are afforded by agency regulations. *Horne* v. *United States*, 190 Ct. Cl. 145, 419 F. 2d 416 (1969). Internal Revenue Manual (IRM), Section 0300.1414 states: 'All appointees to continuing positions in the excepted service will be required to serve a one-year trial period equivalent to the probationary period served by employees in the competitive service.' IRM 0771.1, § 222(1)(d), which contains Internal Revenue Service appeals procedures, excludes from coverage '* * * an employee currently serving a probationary or trial period; * * *.' Therefore, plaintiff was entitled to only those limited rights which the Civil Service Commission regulations give probationary employees.

"5 C.F.R. § 315.805 provides that when an agency proposes to terminate a probationary employee based on conditions arising before his appointment, the employee is entitled to:

"(1) Notice of the proposed adverse action stating the reason for the proposed action;

"(2) A reasonable time for filing a written answer; and

"(3) Notice of the adverse decision at the earliest practicable date.

The only right of appeal given by 5 C.F.R. § 315.806 is that the probationary employee may appeal to the Commission if the appeal is based upon discrimination because of race, color, religion, sex, or national origin; or partisan political reasons, marital status or improper discrimination because of a physical handicap; or improper procedure. None of these grounds are involved herein. Plaintiff was accorded all of the rights he was entitled to under the Civil Service Commission regulations. On May 30, 1972, he received a written notice of proposed removal stating the reasons for the action. He submitted his written reply on June 15, 1972; his reply was considered by the District Director; and he was terminated on June 20, 1972.

"Plaintiff's dismissal was not arbitrary or capricious. One of the specifications of the charges was that enforcement action had to be taken to enforce collection of his 1968 income taxes. He admitted this in his reply. It is within the administrator's discretion to dismiss an attorney employed by the IRS who is still serving within his probationary period and who has failed to voluntarily pay his own income taxes. See *Birnholz* v. *United States*, 199 Ct. Cl. 532 (1972). See, also, the court's order filed November 20, 1974, dismissing the petition in *Pargo* v. *United States*, 205 Ct. Cl. 870, 871, which reads in part:

> The court also finds that plaintiff's removal was effected in compliance with the applicable regulations of the Navy and the Civil Service Commission relating to plaintiff's failure to pay his just financial obligations in a manner which does not reflect adversely on the Government as an employer; that the administrative decisions are not arbitrary or capricious and that such decisions are supported by substantial evidence.

"Based on the reasons above stated, we allow defendant's motion for summary judgment. Plaintiff's petition is hereby dismissed."

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No. 264-74. June 27, 1975

Ohio Tool & Manufacturing Co., Inc.

*Contracts; interpretation; contract as a whole; facilities contract; rental payments for use of Government property.*— On June 27, 1975 the court issued the following order:

Before Cowen, *Chief Judge*, Durfee, *Senior Judge*, and Skelton, *Judge*.

"This case is before the court on cross motions for summary judgment. It involves the review of a decision rendered by the Armed Services Board of Contract Appeals with respect to rental collected from plaintiff under the provisions of a facilities contract covering the use of certain Government-owned forging equipment. After considering the motions and briefs of the parties, and after hearing oral argument, the court finds that the following facts found by the ASBCA in its decision of April 12, 1974, are supported by substantial evidence:

"(1) The facilities contract was executed July 15, 1966, and was to terminate on August 25, 1971. The contract contained provisions requiring plaintiff to pay rent for the use of the leased equipment and also provisions authorizing plaintiff to use the facilities without charge under certain specified conditions.

"(2) Plaintiff requested that the date for beginning rental payments be advanced from November 1, 1966 to May 1, 1967, but defendant denied the request and demanded that plaintiff pay rental in the amount of $3,750.36 for November and December 1966. Plaintiff declined, requested a decision by the contracting officer, but paid the amount demanded prior to the adverse decision of the contracting officer dated November 29, 1967.

"(3) On November 1, 1968, the parties executed a rental agreement which set forth detailed procedures for the computation of rental charges to be paid by plaintiff for the use of the facilities. From November 1, 1966 through June 1969, plaintiff paid defendant, pursuant to the agreement, a total of $51,558.99, but refused to pay any rental thereafter. Defendant computed the rent for the period from July 1, 1969 through August 25, 1971, in the amount of $48,319.17 and withheld this sum from amounts due plaintiff under other contracts.

"(4) Prior to August 25, 1971, the date the contract was to expire, the Government refused to extend the contract as requested by plaintiff, and notified it to prepare to return the equipment to the Government. Plaintiff continued to use the facilities after the contract expired, and on September 20, 1972, the contracting officer issued a final decision assessing plaintiff a charge for the use of the equipment from September 1, 1971 through July 31, 1972, in the amount of $18,114.14. This amount was also collected by the Government through offset procedures.

"At the hearing of plaintiff's appeal to the ASBCA, plaintiff did not present any testimony but subsequently filed the deposition of plaintiff's president in which he asserted that the Government had induced plaintiff to use the equipment on a rent-free basis and that he was coerced into paying rent under threat of having the facilities contract terminated. These assertions were categorically denied in an affidavit of a Government official, and the Board found that the Government's version of the facts was correct [74–1 BCA para. 10,568]. Our review of the facts is limited to the record before the Board. In view of the direct conflict in the affidavits, we cannot say that the Board's finding is not supported by substantial evidence.

"After considering the provisions of the contract and the conduct of the parties in connection therewith, the Board concluded, as a matter of law, that when the several provisions of the contract are construed together, plaintiff was obligated to pay the rent as found by the contracting officer.

"Although the court is not bound by the Board's decision on questions of law (*Morrison-Knudsen Co.* v. *United States*, 170 Ct. Cl. 757, 345 F.2d 833 (1965)), the court concludes, as a matter of law, that the Board's interpretation of the contract is correct and that its decision should be affirmed. As to the quantum of rent due for the post-contract use for which defendant collected $18,114.14, the Board held that the question should be remanded for negotiation by the parties.

"Except as to the quantum of rent due defendant for the post-contract period,

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, plaintiff's motion for summary judgment is denied, and plaintiff is entitled to recover nothing.

"Pursuant to Rule 149(b) and 86 Stat. 652, the issue as to the amount of rental due for the post-contract usage is remanded to the ASBCA for determination by stipulation, or administrative proceedings. Further proceedings in this court shall be stayed for a period of six months from the date of this order. Defendant's counsel is designated to advise the court by letter to the clerk of the status of the remand proceedings, and such advice shall be given at intervals of 90 days or less, commencing with the date of this order."

On September 22, 1975 the decision of the administrative judge was filed, and on September 30, 1975 the petition was dismissed following filing of plaintiff's motion to dismiss endorsed "No objection" by defendant.

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APP. NO. 1-75. JUNE 27, 1975

C. W. McGhee, et al. (Creek Nation East) v. The United States and The Seminole Indians of the State of Florida and The Seminole Nation of Oklahoma

*Indian claims; appeal from Indian Claims Commission; Florida lands.*—The Creek Nation East of the Mississippi filed a petition in the Indian Claims Commission on August 9, 1951 which was assigned Docket No. 280, and which asserted a claim for lands in northern Florida alleged to have been lost to the Creeks by the Treaty of August 9, 1814 or by the Camp Moultrie Treaty. The Commission by order dated September 13, 1974 dismissed with prejudice the claims in said docket because the Creek Nation had failed to comply with Commission orders directed to them in connection with the filing of materials relative to their claims, thereby substantially hindering the orderly progress of the litigation of the claims in consolidated Docket Nos. 73, 151 and 280 and substantially prejudicing the rights of the Seminole plaintiffs to an expeditious final determination of their claims in Docket Nos. 73 and 151. The Creek Nation East has filed an appeal from the order. On June 27, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DURFEE, *Senior Judge*, SKELTON, NICHOLS, KUNZIG and BENNETT, *Judges*.

"This case involves an appeal from an order of the Indian Claims Commission, issued September 13, 1974, which dismissed the claims of the appellant under Commission Docket No. 280 and ordered that said Docket No. 280 be severed from Dockets Nos. 73 and 511. The case is presently before the court on motion of the Seminole Indians of the State of Florida and the Seminole Nation of Oklahoma, appellees, to dismiss the appeal. Upon consideration of the motion and the appellants' response, the court finds:

"(a) the Commission's order was issued pursuant to the authority and discretion vested in the Commission by Section 27(b) of the Indian Claims Commission Act;

"(b) The recitals in the Commission's order and the facts before us on the pending motions are sufficient to establish that the action of the Commission was justified and did not constitute an abuse of its discretion, and

"(c) The order of the Commission was not arbitrary, or capricious, and did not constitute a denial of due process.

"IT IS THEREFORE ORDERED that the motion to dismiss is granted, the order of the Commission is affirmed, and this appeal is hereby dismissed."

On October 3, 1975 the court denied appellant's motion for rehearing.

No. 283-72. June 30, 1975

American Dredging Company

*Contracts; default termination; failure of progress; diligence of performance; hard rock conditions; drilling and blasting.*—On June 30, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges.*

"Two issues are presented in this Wunderlich Act review case: (1) whether the hard rock encountered in 5 channel sections constituted a changed condition requiring a contract adjustment; and (2) whether plaintiff's termination for default was proper. The Corps of Engineers Board of Contract Appeals (Board) found the hard rock did constitute a changed condition to the extent that it required more drilling and blasting than plaintiff should have contemplated from the pre bid information. With regard to the default termination, the Board determined it proper, given plaintiff's failure to perform diligently after recognizing the changed condition. 72–1 BCA ¶ 9316. Trial Judge Willi, in his recommended decision filed September 24, 1974 [20 CCF para. 83,-379], modified, more in the plaintiff's favor, the Board's determination of the changed condition. The trial judge found no substantial evidence for the Board's determination that plaintiff should have contemplated at least some blasting and drilling would be necessary. He found there was no substantial evidence at bid time that *any* blasting and drilling were necessary. Upon consideration of the briefs submitted and with the aid of oral argument of counsel, we reject the trial judge's modification and affirm the original Board opinion.

"Plaintiff, as low bidder, was awarded a $3,852,000 contract by the Army Corps of Engineers on January 5, 1966. Under the terms of the contract, plaintiff was required to dredge the 24-mile shipping channel in Cape Fear River, between Southport and Wilmington Harbor, North Carolina from an existing depth of 34 feet to a new 40-feet depth, plus certain maintenance dredging. Plaintiff received notice to proceed on January 17, 1966 and was required to complete the contract within 870 calendar days, i.e., no later than June 5, 1968. While attempting to perform the contract, plaintiff encountered a rock area in 5 channel sections, the hardness of which was not revealed in the bidding information. The hard rock area could not be removed by hydraulic dredges equipped with rock cutterheads, as plaintiff had anticipated, but rather necessitated drilling and blasting, a much more costly method of removal.

"On March 6, 1968, plaintiff submitted its formal claim of changed conditions. In this claim, plaintiff asserted that nothing in the contract documents indicated that the hard rock encountered could only be removed by drilling and blasting. The contracting officer rejected this claim on April 9, 1968. On June 6, 1968, one day after the contract completion date, plaintiff was terminated for default for failure to prosecute diligently the work. Plaintiff, on June 10, 1968, timely appealed both the rejection of the changed condition and the default termination.

"The Corps of Engineers Board of Contract Appeals (Board) concluded that an experienced, knowledgeable dredging contractor such as plaintiff, after reviewing the subsurface data and core boring samples made available by the Government, should have known that some drilling and blasting would be necessary to remove the hard rock. But since the subsurface data understated the degree of hardness of the rock encountered and did not accurately reflect the elevations at which such hard rock would be found, plaintiff was entitled to a contract adjustment for changed conditions. The Board did affirm the default termination, finding that plaintiff failed to continue diligent performance of the work after January 1968. In reaching this conclusion, the Board determined plaintiff should have known, by January 1968, that drilling and blasting was the only satisfactory means of diligently performing the contract work.

"We affirm the Board on both counts.

"With regard to the changed condition claim, we find support in the record for the Board's conclusion that plaintiff should have known at least some blasting and drilling would be necessary. A competitor of plaintiff's, Mr. Aaron W. Hendry, testified that his company and at least three other bidders were sufficiently alarmed by the Government's boring test logs to do their own additional test borings in the rock areas prior to bidding. As a result, all four companies bid the job on the basis of some degree of drilling and blasting. The Government's own estimate of the contract cost prior to bidding also was based on the belief that some drilling and blasting would be required. At the very least, this testimony is supportive of the Board's conclusion that plaintiff as an experienced, knowledgeable dredging contractor should have known that some drilling and blasting would be necessary.

"It is true that plaintiff and two other bidders stated they intended no drilling and blasting. However, even though there may have been evidence before the Board upon which it could have based a decision in favor of plaintiff, the decision which the Board made may still be found to be supported by substantial evidence when the whole record is considered. *River Construction Corp.* v. *United States*, 159 Ct. Cl. 254, 261 (1962). In the instant case, such substantial evidence is present to support the Board's conclusion.

"The Board's affirmation of plaintiff's termination for default for failure to proceed diligently is likewise supported by substantial evidence. Plaintiff's own executive, Mr. August Pistilli, testified that the very hard rock problems were first encountered in July 1967, and that redesign attempts to improve the cutters and cutting teeth of the hydraulic dredges were a total failure. In fact, he stated the cutters lasted less than four hours and individual teeth failed within a single hour. The effect of this rapid destruction of the cutters was to prevent continued timely performance of the contract relying solely on plaintiff's dredges. It should have been apparent to plaintiff as early as July 1967 that only drilling and blasting could shatter the hard rock into fragments removable by dipperstick dredges. Yet plaintiff offered no satisfactory explanation as to why it delayed a decision to commence drilling and blasting until May 1968. Thus, the Board's determination that plaintiff failed to live up to its contractual obligations to perform diligently, using whatever tools and methods were required to dredge the channel down to 40-feet depth, is supported by substantial evidence.

"Since the question of adjustment (in money and time) to which plaintiff was entitled on account of the changed condition was reserved by the parties, the Board made no determination of dollar amounts, if any, owed to the Government.

"IT IS THEREFORE ORDERED THAT the recommended decision of the trial judge be rejected, the decision of the Corps of Engineers Board of Contract Appeals be affirmed, and this case be remanded back to the Board and contracting officer for further proceedings as indicated in the Board decision."

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NO. 60-71. JULY 10, 1975

Ampex Corporation

*Pleading and practice; production of documents; attorney-client privilege.*—On July 10, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KUNZIG, and BENNETT, *Judges*.

"Pursuant to Rule 53(c)(2)(i) plaintiff seeks review of an order entered January 23, 1975, by the trial judge denying reconsideration of his order of October 29, 1974. Plaintiff also contests the trial judge's allowance of defendant's motion for production of documents. The trial judge has, pursuant to the rule, certified his order for appellate review on the basis that it involves an issue of controlling importance.

"Plaintiff brought suit to recover alleged overpayment of federal income taxes and interest thereon for its taxable year ended May 1, 1965. In broad terms the central issue of the case is whether or not Ampex World Operations, S.A. (AWOSA) was a controlled foreign corporation within the meaning of section 957 of the Internal Revenue Code of 1954, as amended. A foreign corporation is a controlled corporation if more than 50 percent of the total combined voting power of all classes of its stock entitled to vote is held by an American corporation or person. In 1964 plaintiff formed the new affiliate AWOSA with two classes of stock—common and preferred—each of which possessed 50 percent of the nominal voting power. The preferred stock was sold to foreigners. The parties stipulated that the purpose of the formation of AWOSA and issuance of its preferred stock to non-United States shareholders was to avoid the classification of AWOSA as a controlled foreign corporation.

"The Government hopes to prove that the preferred stock was sold to foreigners who would either agree to vote their shares as designated by plaintiff, or who for other reasons could be depended upon to act in conformity with plaintiff's wishes. Treas. Reg. § 1.957–1(b)(2) (1965) denies effect to arrangements which shift nominal voting power away from United States shareholders, where, in reality, the substantive voting power is retained. In addition, the Regulations provide that where a foreign corporation has two classes of stock, one of which is held by an American corporation or person, the voting power of the other will be disregarded if three requirements are met, one being that foreign shareholders do not exercise their voting rights independently.

"Defendant seeks production, *inter alia*, of any legal or advisory opinions which discuss methods by which plaintiff could conduct its foreign operations through a so-called 'noncontrolled foreign corporation' without relinquishing actual or effective control over the latter's affairs. Plaintiff asserts that any such opinions are privileged from discovery under the attorney-client privilege. The trial judge ordered that plaintiff produce the opinions or have its suit dismissed. He did so in the belief that 'fundamental notions of fairness or of waiver, or both' required production of the documents otherwise protected from disclosure by the attorney-client privilege, because the materials were essential to the Government's defense of the suit. We disagree.

"It is true that the attorney-client privilege is not absolute; it can be waived. 4 MOORE'S FEDERAL PRACTICE ¶26.60[2] (2d ed. 1974). The mere bringing of a suit does not ordinarily waive the privilege. There are situations, however, where the attorney has participated in the acts which are the essence of the controversy and where it would be unfair to allow the plaintiff to introduce only selective evidence and bar the defendant from inquiring as to other relevant circumstances involved in the same transaction. For instance, it has been held that a party may not reasonably claim that he relied on advice of counsel and then shut his adversary off from finding what that advice was. *Trans World Airlines, Inc.* v. *Hughes*, 332 F. 2d 602, 615 (2d Cir. 1964), *cert. dismissed*, 380 U.S. 248, 249 (1965). And *cf.* also *Malco Mfg. Co.* v. *Elco Corp.*, 307 F. Supp. 1177 (E.D. Pa. 1969); *Gorzegno* v. *Maguire*, 62 F.R.D. 617, 621–22 (S.D. N.Y. 1973); *Jack Winter, Inc.* v. *Koratron Co.*, 50 F.R.D. 225, 229 (N.D. Cal.

1970). To do so is to use the privilege as both sword and shield. That is impermissible.

"In the instant case defendant needs to prove that the foreign shareholders do not exercise their voting rights independently. Defendant has access to the various officers and shareholders of the firm and may discover all nonprivileged documents which are relevant. Communications made in confidence between plaintiff and counsel are not the essence of the controversy and are not essential to the defense. That the attorney-client communications may be relevant we assume, but this is not the criterion for overuling the privilege. If it were the sole criterion, there would be no privilege. Good cause, required by Rule 71(a)(2) is not shown here.

"Plaintiff has not waived its attorney-client privilege. It does not base its claim on the contents of communications with its attorneys, and it has never made the advice of its attorneys part of the case. To the extent that the trial judge allowed production of all correspondence, notes, memoranda and recommendations concerning the effect of the newly enacted subpart F provisions of the Revenue Act of 1962 on plaintiff, and ways or means of modifying plaintiff's foreign operations to minimize United States taxation, other than such papers protected by the attorney-client privilege, he was correct in doing so. The agreements, understandings and actions of the shareholders and officers of the companies are the operative facts, not their tax counsel's opinions in this case.

"The attorney-client privilege fosters the full and uninhibited communication of information and ideas between a client and his attorney. This is essential to afford the client access to the full panoply of his rights under the law. *Colton* v. *United States*, 306 F. 2d 633, 636 (2d Cir. 1962), *cert. denied*, 371 U.S. 951 (1963); *Gorzegno* v. *Maguire*, *supra;* 8 WIGMORE, EVIDENCE § 2291 (McNaughton Rev. 1961). Privilege is interpreted as it is 'known and understood in the law of evidence.' *Benson* v. *United States*, 133 Ct. Cl. 11, 21, 130 F. Supp. 347, 353 (1955); *cf.* Ct. Cl. Rule 74 and Fed. R. Civ. P. 26(b) and 34; *Kaiser Alum. & Chem. Corp.* v. *United States*, 141 Ct. Cl. 38, 45, 157 F. Supp. 939, 944 (1958). Privilege is also defined by the FEDERAL RULES OF EVIDENCE, Rule 501, as 'governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.' WIGMORE states that the attorney-client privilege is the oldest of all common-law privileges for confidential communication. 8 WIGMORE, EVIDENCE § 2291 (McNaughton Rev. 1961). The Supreme Court has recognized that public policy supports confidential communications between attorney and client. *United States* v. *Louisville & Nashville R.R. Co.*, 236 U.S. 318, 336 (1915). *NLRB* v. *Sears, Roebuck & Co.*, 421 U.S. 132, 149, 154 (1975). It is a rare case where the privilege will be deemed waived. This is not such a case.

"IT IS THEREFORE ORDERED that the order of the trial judge allowing defendant's motion for production of documents to the extent that they are attorney-client communications and his order refusing to reconsider same and holding that plaintiff may invoke the attorney-client privilege only at the price of dismissing its suit are, on review pursuant to request of plaintiff and certification of the trial judge, reversed."

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NO. 44-74. AUGUST 1, 1975

Studio Girl-Hollywood, Inc.

*Taxes; Federal Insurance Contribution taxes; sales agents v. employees; alleged discrimination in assessment; severing of issues for trial.*—On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"In this tax refund case the principal issue is whether the earnings of certain persons who sold plaintiff's merchandise were sales agents or employees whose earnings constituted wages for which the taxpayer owed Federal Insurance Contribution Taxes. Defendant has filed a motion for partial summary judgment covering paragraph 13 of plaintiff's petition, wherein plaintiff alleged that the assessment and collection of the taxes were illegal because the action of defendant's representatives was arbitrary and capricious in discriminating against plaintiff as compared to its similarly situated competitors. Upon consideration of the motion and plaintiff's opposition thereto, the court concludes:

"The defendant's contention that the court is without jurisdiction of the claim alleged in paragraph 13 of the petition, because that ground of relief substantially varies from the ground set forth in the claim for refund, is rejected. On February 11, 1975, plaintiff filed an amended claim for refund with the Internal Revenue Service, specifying the exact grounds that are set forth in paragraph 13 of the petition. The amended claim was filed well within the two-year period specified in Section 6511(a) of the Internal Revenue Code. The second ground upon which defendant's motion for partial summary judgment is based is that the taxpayer is not within the class of persons who may properly claim tax relief on the theory of discrimination, and that portion of the motion should be denied without prejudice and the case remanded for trial.

"IT IS THEREFORE ORDERED that defendant's motion with respect to the second ground upon which it is based is denied without prejudice and the case is remanded to the trial division with instructions to sever the principal issue described above from the issue of discrimination and to defer all proceedings relating to the latter issue until after the court has had an opportunity to review the trial judge's decision on the principal issue. Further proceedings thereafter shall be the same as specified in the court's order in No. 139-73, *Queen's Way to Fashion, Inc.* v. *United States*, issued April 12, 1974, 204 Ct. Cl. 836."

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No. 76-74. AUGUST 1, 1975

Leopold J. Gunston

*Civilian pay; claim of discrimination re non-selection for trainee position; failure to file timely administrative appeal; discretion of Civil Service Commission re entertainment of untimely appeal; laches.*—On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on defendant's motion for summary judgment and plaintiff's opposition thereto. Upon consideration thereof, the court finds:

"(1) On June 4, 1968, plaintiff filed a complaint that his non-selection as a Benefit Examiner Trainee in the Social Security Administration was due to discrimination; on August 5, 1968, after an investigation, the Deputy Assistant Commissioner for Employee Relations found that plaintiff's failure to be selected was due to his low Civil Service test score.

"(2) Plaintiff appealed the decision, and on November 30, 1968, he was appointed to a position as Benefit Examiner Trainee; on January 30, 1970, the Director of Equal Employment Opportunity dismissed his complaint as moot but advised plaintiff that he could appeal the decision within 15 days to the Civil Service Commission.

"(3) Plaintiff did not appeal the final decision of the Agency until October 11, 1972, stating that his untimely appeal was due to the fact that he was suffering from amnesia because of an automobile accident and because the Agency had stated no remedy was available; on February 12, 1973, the Board of Appeals and Review of the Civil Service Commission rejected plaintiff's claim that he was physically unable to file a timely appeal and found that he had been employed on a full-time basis during most of the period after the Agency decision. Accordingly, the Board held that his appeal was untimely and his request for a rehearing was rejected.

"(4) On May 22, 1970, the Civil Service Commission directed the Social Security Administration to remove plaintiff from his employment on the grounds of medical unsuitability; on July 26, 1970, he filed a complaint, similar to his 1968 complaint, in which he again raised the issue of discrimination.

"(5) On December 23, 1971, the United States District Court for the Northern District of California set aside the determination that plaintiff was unsuitable for employment and thereafter awarded him more than $16,000 in back pay as a result of a finding that he was ready, willing, and able to work from June 1, 1970 to December 23, 1971, the date of the court's decision. This finding was made at plaintiff's request and was essential to his recovery of back pay.

"Based on the foregoing, the court concludes as a matter of law:

"(A) Plaintiff's failure to appeal the decision complained of until nearly 2 years and 9 months after the final decision was rendered bars the maintenance of his suit in this court, since the administrative appeal was mandatory and had to be made within the time specified in the regulations. *Piccone* v. *United States*, 186 Ct. Cl. 752, 407 F. 2d 866 (1969) and cases cited therein.

"(B) As a result of the finding made by the District Court that plaintiff was ready, willing, and able to perform his duties from June 1970 to December 1971, and his acceptance of the award of back pay, he is collaterally estopped to assert that his failure to file a timely appeal from the Agency decision of January 30, 1970, was due to his physical disability.

"(C) The Civil Service Commission had the discretion to entertain plaintiff's untimely appeal but did not abuse its discretion in refusing to do so, and its finding that his failure to file such a timely appeal was not due to physical disability is supported by substantial evidence.

"(D) If it should be urged that plaintiff was excused from appealing the Agency decision of January 30, 1970, which was by implication adverse as to plaintiff's back pay claim, because any administrative appeal at that time would have been futile (*see Pettit* v. *United States*, 203 Ct. Cl. 207, 488 F. 2d 1026 (1973)), the answer is that in that event the cause of action was fully accrued on January 30, 1970, and a delay of over four years thereafter in bringing suit constituted laches of such long duration as to be inexcusable. Defendant shows without contradiction that pertinent records have been destroyed (defendant's exhibit 2). *See*, *Brundage* v. *United States*, 205 Ct. Cl. 502, 504 F. 2d 1382 (1974), *cert. denied*, 421 U.S. 998 (1975).

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted and plaintiff's petition is hereby dismissed."

No. 204-74. AUGUST 1, 1975

Wilhelmena R. Bell

*Civilian pay; race and sex discrimination claim; non-promotion; claim for back pay; laches; demotion; refusal to transfer duty station; failure to exhaust administrative remedies.*—On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges.*

"This case is before the court on defendant's motion for summary judgment. Plaintiff, a black female, sues for back pay based on race and sex discrimination in course of her civilian employment in the United States Navy. The claim as stated breaks down into three claims. 1.) Period beginning June 1964 and ending April 4, 1971, back pay for discriminatory non-promotion to Grade GS–12. 2.) Period December 5, 1972 to July 6, 1973, discriminatory demotion to Grade GS–11. 3.) Period beginning July 6, 1973, back pay for discriminatory separation on alleged ground of refusal to transfer duty station from Washington, D.C. to Norfolk, Virginia, to accompany activity in which employed. Plaintiff admits she was employed at GS–12 between periods 1 and 2 and does not claim she was a candidate for a higher paying position during that period or was qualified to hold such a position. She claims reinstatement at GS–12.

"The back pay claim for period 1 must be dismissed on account of laches, in light of all the circumstances of the case, suit on such claim not having been brought until over three years after the latest possible date of accrual. *Jackson* v. *United States*, 179 Ct. Cl. 29, *cert. denied*, 389 U.S. 985 (1967). Plaintiff could have asserted a claim for back pay while prosecuting her claim for prospective relief. Defendant, on settling the prospective portion of the claim naturally would treat the whole as settled and relax its efforts to accumulate and preserve evidence. The claim for period 2 does not assert a claim within the jurisdiction of the court because plaintiff suffered no loss of pay by the demotion, and she failed to exhaust her administrative remedies. *Jackson* v. *United States, supra.* The claim for period 3 and for reinstatement must be dismissed because plaintiff fails to show exhaustion or even initiation of available administrative remedies, and does not allege any reason or excuse for such non-exhaustion except a reason or excuse applicable, if at all, only to period 1.

"Accordingly, upon consideration of the pleadings, defendant's motion for summary judgment, plaintiff's opposition thereto, and the briefs and representations of the parties but without oral argument, it is ORDERED that defendant's motion for summary judgment is allowed and the petition is dismissed."

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NO. 254-74. AUGUST 1, 1975

Bobby Hughes

*Employment contract; authority of Government agent.*— On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on defendant's motion for summary judgment and plaintiff's opposition thereto. Upon consideration thereof, the court finds that plaintiff's petition is based on the claim that during the period from June 1971 through January 1972, he was employed as an undercover agent for the Bureau of Narcotics and Dangerous Drugs. According to plaintiff, 'no contract of employment was signed between the parties, but plaintiff was assured by agents of defendant that he would receive adequate wages, expenses, and a reward of approximately $1,000.00 for every person he identified as violating the drug laws of the United States.' Plaintiff also claims that, as a result of the defendant's failure to pay plaintiff for services rendered, he lost wages and bonuses from his former private employment, incurred medical expenses of $4,000, and otherwise suffered actual and consequential damages amounting to $50,000. Defendant has filed a number of affidavits and documentary exhibits demonstrating that the Federal employees with whom plaintiff dealt did not have authority to employ him or to obligate the Government to pay him compensation. Plaintiff's opposition raises no issue of fact. The unsworn statement headed 'Affidavit' attached to his opposition cannot be accepted as an affidavit but, even if accepted, it fails to raise a factual issue regarding the authority of defendant's agents to make oral contracts and representations binding on the Government. *See Housing Corp. of America* v. *United States*, 199 Ct. Cl. 705, 711, 468 F. 2d 922, 925 (1972).

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted, and plaintiff's petition is dismissed."

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NO. 374-74. AUGUST 1, 1975

The Armstrong Rubber Company

*Taxes; timeliness of claim for refund re additional items.*—An August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on defendant's motion for partial summary judgment and plaintiff's opposition thereto. Defendant's motion seeks dismissal of that portion of plaintiff's petition which seeks a refund of income taxes on the ground that the taxpayer is entitled to an investment credit on certain of its assets. Defendant's motion is based on the ground that the assets on which the credit is claimed were not included in a timely claim for refund. Upon consideration of the motion and plaintiff's opposition, the court finds:

"On March 27, 1970, the taxpayer filed a timely claim for refund in which it asserted that it was entitled to certain investment credits, specifically listing a schedule containing 14 different assets. During the investigation of the claim by an Internal Revenue Agent, the taxpayer drew up an additional schedule of assets, handed it to the agent involved, but thereafter did not make any revision of the claim for refund.

"Upon consideration thereof, the court concludes that we lack jurisdiction on the ground that the claim for refund did not specifically raise, nor did its language contain, a timely application for refund as to the list of assets handed to the I.R.C. agent but not included in the only claim for refund filed by plaintiff. *Union Pac. R.R.* v. *United States*, 182 Ct. Cl. 103, 389 F. 2d 437 (1968). The court also concludes that plaintiff's claim for refund does not fall within the rule announced in our decision in *Consolidated Coppermines Corp.* v. *United States*, 155 Ct. Cl. 731, 296 F. 2d 743 (1961).

"IT IS THEREFORE ORDERED that defendant's motion for partial summary judgment is granted and those portions of plaintiff's petition seeking an investment credit, with respect to assets which were not listed in the claim for refund filed with the Internal Revenue Service, are hereby dismissed."

On October 1, 1975 the court denied plaintiff's motion for rehearing to alter or amend judgment.

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No. 432-74. AUGUST 1, 1975

James E. Barnum

*Military pay; promotion; administrative discretion; Court of Claims jurisdiction; declaratory relief.*—On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and KASHIWA, *Judges.*

"This case comes before the court on defendant's motion to dismiss plaintiff's petition. Plaintiff, an Army officer on active duty in Taiwan, seeks a retroactive promotion from the rank of Major to Lieutenant Colonel or, alternatively, for an order directing that he be placed before an Army Standby Advisory Board to be considered for promotion. He also seeks retroactive pay and allowances if the promotion is granted, requests that a challenged efficiency report be expunged from his records, and asks the court to render a declaratory judgment that certain regulations relating to the Army Board for the Correction of Military Records are unconstitutional. Upon consideration of defendant's motion and plaintiff's objection thereto, the court finds:

"(1) Plaintiff challenges an efficiency report rendered for service during the period October 9, 1967 to June 26, 1968, on the ground that the reporting system used at the time the efficiency report was rendered was subject to a general inflation in the case of some officers and that the report rendered as to plaintiff under the new system unduly penalized an officer such as plaintiff, whose rater and endorser made a conscientious effort to deflate the rating system in response to guidance from headquarters.

"(2) In an effort to have the challenged efficiency report removed from his records and to obtain promotion, plaintiff has appealed to the Army Special Review Board, Office of the Adjutant General, and to the Army Board for the Correction of Military Records.

"(3) The Army Special Review Board found that the evidence submitted by plaintiff was not sufficient to justify withdrawal or alteration of the efficiency report, and the Army Board for the Correction of Military Records denied his application.

"(4) For the purpose of defendant's motion, plaintiff's allegations regarding the circumstances under which the challenged efficiency rating was made, are accepted as true. However, such circumstances did not invalidate the discretionary authority of Army officials to deny plaintiff's promotion.

"Having decided that defendant's motion to dismiss should be treated as a motion for summary judgment in order to consider the documentary evidence offered by plaintiff, the court concludes as follows:

"(A) The retroactive promotion of plaintiff with back pay would involve an intrusion into the discretionary military promotion processes which is not justified in this case where plaintiff does not have a clear legal entitlement to the pay of a higher rank. *Doggett* v. *United States*, *ante* at 478; *Cooper* v. *United States*, 203 Ct. Cl. 300 (1973); *Abruzzo* v. *United States*, 206 Ct. Cl. 731, 513 F. 2d 608 (1975).

"(B) Since the court is not authorized to grant plaintiff monetary relief in this case, his request for an order to have the challenged efficiency report removed from his record and for a judgment declaring the regulations unconstitutional must be denied on the ground that these claims are outside the court's jurisdiction. *See Austin* v. *United States*, 206 Ct. Cl. 719, cert. denied, 423 U.S. 911 (1975); and *Jankovic* v. *United States*, 204 Ct. Cl. 807 (1974). This holding is also applicable to plaintiff's request for an order that he be placed before the Army Standby Advisory Board for purposes of early promotion.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment is granted and plaintiff's petition is hereby dismissed."

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No. 19-75. AUGUST 1, 1975

Helen S. Burnette

*Taxes; State income tax; withholding of by United States.*—On August 1, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on defendant's motion to dismiss the petition and plaintiff's motions for summary judgment and to strike. The plaintiff, a resident of New Hampshire, is employed at the Portsmouth Navy Yard, which is situated in Kittery, Maine. The United States has withheld and continues to withhold sums from her pay and turns over said sums to the State of Maine on account of income taxes that State imposes. Plaintiff would have us hold that such collection of taxes for Maine is unconstitutional, to put a stop to it by means within our power, and she asks for such other relief as may be required.

"To the extent the petition seeks injunctive or declaratory relief, it calls for action outside our jurisdiction. *United States* v. *King*, 395 U.S. 1 (1969). If, as a *pro se* petition, it is also construed to seek judgment for Maine taxes already withheld, we cannot grant such relief for reasons fully explained in *Clincher* v. *United States*, 205 Ct. Cl. 8, 499 F. 2d 1250 (1974), *cert. denied*, 420 U.S. 991 (1975). *See also*, 36 Maine Revised Statutes Annotated § 5254 (enacted 1969). Thus we do not reach the constitutional question.

"THEREFORE, on the motions and briefs of the parties, but without oral argument,

"IT IS ORDERED that the plaintiff's motions for summary judgment and to strike are denied, the defendant's motion to dismiss is allowed, and the petition is dismissed."

On October 3, 1975 the court denied plaintiff's motion for rehearing.

No. 206-73. AUGUST 15, 1975

Bryan B. Riley

*Military pay; correction of military records; complete relief; remand to administrative board.*—On August 15, 1975, the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges*.

"This case comes before the court on plaintiff's request, filed June 20, 1975, for review of the trial judge's order of March 5, 1975. Upon consideration thereof, together with defendant's response in opposition thereto, without oral argument, in accordance with the order entered in the case of *Sanders* v. *United States*, Ct. Cl. No. 157-74, on June 13, 1975, *ante* at 962.

"IT IS ORDERED that plaintiff's said request for review in this case be and the same is denied.

"IT IS FURTHER ORDERED that pursuant to Pub. Law 92-415, 86 Stat. 652, 28 U.S.C. § 1491, Supp. III (1973), the authorities cited in the *Sanders* case order and Court of Claims Rule 149, this case is remanded to the Air Force Board for Correction of Military Records with instructions to reconsider this case consistent with the views expressed in the *Sanders* case order and to make findings of fact showing the basis for its conclusions on such reconsideration.

"In its reconsideration of plaintiff's application for relief, the Board shall consider the record heretofore made, and in its discretion, may grant a hearing and consider such other evidence and materials as may properly be presented by the parties.

"After completion of the Board's proceedings, the record thereof will be presented in normal course for action by the Secretary of the Air Force.

"Counsel for the plaintiff is designated under Rule 149(f) to advise the trial judge of this court and opposing counsel of the status of proceedings on remand at intervals of 90 days or less, beginning with the date of this order.

"These proceedings are stayed for a period not to exceed six months from the date of this order, pending the Board's reconsideration upon remand."

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No. 55-75. AUGUST 22, 1975

Louis T. M. Myles, Jr.

*Military pay; correction of military records; eligibility for promotion; Officer Effectiveness Report.*—On August 22, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, DAVIS and NICHOLS, *Judges.*

"This case comes before the court on defendant's motion, filed May 7, 1975, for summary judgment. Upon consideration thereof, together with the response in opposition thereto, without oral argument, it is concluded that plaintiff, as a Reserve officer, does not and cannot seek reinstatement to active duty or promotion by a new selection board [see *Denton* v. *United States*, 204 Ct. Cl. 188, 200 (1974), *cert. denied*, 421 U.S. 963 (1975), and 10 U.S.C. § 8360(a)] and that he does not seek extended active duty pay at the rate of major or lieutenant colonel. Assuming, arguendo, that the court has jurisdiction to consider on its merits the claim for retired pay at the rate for a lieutenant colonel, plaintiff has not shown that the action of the Board for Correction of Military Records in refusing to void the challenged Officer Effectiveness Reports was arbitrary and capricious, in that the letters supporting plaintiff's request to void the reports did not show that he was rated and reported on in a manner less favorable than his contemporaries with whom he competed for promotion. [See *Dorl* v. *United States*, 200 Ct. Cl. 626, 633 *cert. denied*, 414 U.S. 1032 (1973); *Boyd* v. *United States*, *ante* at 1, *petition for certiorari* filed November 23, 1975; and *Barnum* v. *United States*, *ante* at 1024.

"IT IS THEREFORE ORDERED that defendant's said motion for summary judgment be and the same is granted and plaintiff's petition is dismissed."

NO. 863-71. SEPTEMBER 12, 1975

Commonwealth of Pennsylvania, Department of Transportation

*Federal aid for highways; project agreement; extent of United States contribution of cost of construction.*—This case arises out of the program for construction under the Federal-Aid Highways Act, 23 U.S.C. § 101, *et seq.*, of a national system of interstate and defense highways. Plaintiff and defendant entered into a project agreement (23 U.S.C. § 110) for construction of a filtration plant, the agreement, *inter alia*, acknowledging that the Bureau of Public Roads authorized the work to proceed and that Federal funds were obligated for the project not to exceed the estimated total cost shown as $1.3 million. Federal funds are shown as $1,170,000 which is 90% of the said total cost. Plaintiff alleges that the agreement obligated defendant to reimburse it to the extent of 90% of the estimated cost, i.e. that defendant would participate to the extent of $1,170,000. Defendant contends that the parties understood and agreed that the amount of $1,170,000 represented the maximum participation, which could be reduced to effect the most economical solution consistent with the public interest. Plaintiff was paid $1,165,000, the sum of $309,460 being recouped from plaintiff on a subsequent and unrelated voucher. Defendant has counterclaimed for $132,405, plus interest, representing the fair market value of certain inventory items belonging to defendant. In a recommended opinion filed June 17, 1975, Trial Judge Louis Spector concluded that plaintiff is entitled, either under the Act or under the implementing agreements, or both to recover the funds wrongfully recouped. This case came before the court (COWEN, *Chief Judge*, NICHOLS and BENNETT, *Judges*) on plaintiff's motion requesting the court to adopt the recommended decision, defendant having withdrawn its notice of intention to except. Upon consideration thereof, without oral argument, since the court agrees with the trial judge's recommended decision, it granted plaintiff's motion and adopted the decision as the basis for its judgment in this case. On September 12, 1975, by order, the court entered judgment for plaintiff in the sum of $314,460, and entered judgment for defendant on its counterclaim against plaintiff in the sum of $113,750.

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NO. 100-72 SEPTEMBER 12, 1975

Schiavone-Chase Corporation, et al.

*Pleading and practice; trial judge's report; failure to make requested findings and objections.*—On September 12, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, NICHOLS and BENNETT, *Judges*.

"This case comes before the court on plaintiffs' request for review of the trial judge's order, filed August 12, 1975, allowing defendant's motion to strike. Upon consideration thereof, the court finds:

"(1) Plaintiffs' claim involves a substantial sum and defendant has three counterclaims. Following a lengthy trial on all issues involving both plaintiffs' claim and the counterclaims, plaintiffs obtained several extensions of time and thereafter filed their requested findings of fact, all of which related to plaintiffs' claims and none relating to defendant's counterclaims.

"(2) After requesting and obtaining several extensions of time, defendant filed its requested findings of fact, which dealt with plaintiffs' claims and also with defendant's counterclaims.

"(3) Plaintiffs then filed their objections to the defendant's requested findings of fact, plus a document, which, for the first time, contained 23 requested findings of fact dealing with defendant's counterclaims.

"(4) Thereafter, defendant filed its motion to strike plaintiffs' requested findings relating to defendant's counterclaim. By order of August 12, 1975, the trial judge granted the motion and pointed out that he had not been requested to issue and had not issued an order which permitted any variation from the requirements of subparagraphs (1) and (3) of paragraph (c) of Rule 134.

"In light of the foregoing, the court concludes that the trial judge's interpretation of Rule 134 is correct and is also in accord with the procedure that has been followed by attorneys for both plaintiff and defendant in many other cases for a long time.

"IT IS THEREFORE ORDERED that plaintiff's request for review is hereby denied and the action of the trial judge is affirmed."

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NO. 616-71. OCTOBER 3, 1975

Mason & Hanger-Silas Mason Co., Inc.

### ORDER ON PLAINTIFF'S MOTION FOR RECONSIDERATION

Before COWEN, *Chief Judge*, DAVIS, SKELTON, NICHOLS, KASHIWA, KUNZIG, and BENNETT, *Judges*.

This renegotiation case comes once again before the court, presently on plaintiff's motion for reconsideration and additional trial on certain issues which figured in our decision announced June 25, 1975, *ante* at 106, 518 F. 2d 1341. Briefly, plaintiff would have us vacate the judgment and remand the case to the Trial Division for further evidentiary hearing on two points: (1) whether 1965 presents an appropriate historical base for purposes of evaluating "normal earnings," 50 U.S.C. APP. § 1213(e)(1) (1970); and (2) whether in principle renegotiable profit rate should be thought to decline as sales increase in this line of business. On August 14, 1975, the court allowed the motion of John T. Koehler and Judith A. Yannello for leave to file a brief *amicus curiae* directed to the matters raised by the instant motion. Upon a thorough review of the record and briefs, we conclude that the plaintiff has not demonstrated adequate grounds for the extraordinary relief sought and that the motion must be denied.

In *General Elec. Co.* v. *United States*, 189 Ct. Cl. 116, 416 F. 2d 1320 (1969), we considered the standard by reference to which a motion for reconsideration will be evaluated. We recognized that a request for such relief must be received hospitably where the decision has turned upon a point neither briefed nor raised by the parties. A contrary rule applies in the normal case, however.

> * * * where a party adversely affected by the court's decision on the issue has had fair notice that the ques-

> tion may well be in the case, has had a fair chance to present its position, has failed to do so, and gives no sufficient excuse for its failure, a demand for post-decision relief will normally be rejected. * * *.

[189 Ct. Cl. at 117–18, 416 F. 2d at 1321–322.]

We think this rule fully applicable here.

Plaintiff tells us that since the Government bears the ultimate burden of proof in this case under *Lykes Bros. S. S. Co.* v. *United States*, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972), and since the Government at trial did not specifically rely on 1965 profits or on the familiar volume principle, plaintiff was not properly put to its proof on either point. We do not agree.

With respect to 1965 profits as normal earnings, our examination of the transcript indicates that defense counsel's prepared questions for its expert witness, a copy of which was provided for opposing counsel before trial, included an inquiry specifically directed to 1965. Without objection defendant introduced in evidence a summary of plaintiff's profit position for the years 1962 through 1966, inclusive. On cross-examination defendant's expert testified that in his opinion profits as a percentage of sales remained fairly constant during this period, and that any of the years referenced could usefully be considered as a benchmark for evaluating earnings in 1967. In these circumstances, and particularly in view of the explicit wording of 50 U.S.C. APP. § 1213 (e)(1) (1970), we find that at the trial level plaintiff had notice that 1965 earnings could be taken into account. Plaintiff could have adduced rebuttal evidence on this point at the trial, yet for reasons of its own it did not.

The "volume principle," codified in 32 C.F.R. § 1460.10 (b)(3) (1971), also found its way into this litigation at the trial level. Plaintiff's counsel elicited testimony to the effect that under "unusual circumstances" unit fees would be reduced; for example, as in the case of full production runs of ordnance previously fabricated only in much smaller pilot lots. Counsel inquired of his witness whether or not the Government had ever asked plaintiff to reduce fees because of larger quantities. Defendant's expert testified at some length respecting the profit-to-sales ratio. This line of questioning indicates notice that the volume concept was in the case, whether technically brought up by defendant in its evidentiary presentation or in the trial briefs. Moreover, the trial judge was required by law to take judicial notice of the content of 32 C.F.R. § 1460(b)(3) (1971). 44 U.S.C. § 1507 (1970). We think that plaintiff was clearly on notice of the presence of this issue at trial. We are not inclined to provide an opportunity for post-decision bolstering of contentions which we have already rejected. *See Carchia* v. *United States*, 202 Ct. Cl. 723, 731–32, 485 F. 2d 622, 626–27 (1973).

The *amicus* brief raises two matters which merit further comment. First, Mr. Koehler suggests that we delete our citation of his remarks since they were made only with reference to firm fixed-price contracts. We note that he made no distinction between contracts of that species and those of the cost-plus-fixed-fee variety at the time of his speech. Moreover, 32 C.F.R. § 1460.10(b)(3) (1971) makes no such distinction. Second, our opinion specifically disclaims reliance on any single fact or factor as a rigid formula or fixed limitation on allowable profit. Normal earnings were but one of several factors entering our judgment, and we reiterate that view here. With due respect, plaintiff and amici misapprehend the thrust of the opinion.

IT IS THEREFORE ORDERED that, upon reconsideration of the entire record, without oral argument, plaintiff's motion for reconsideration and additional trial is denied.

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NO. 108–74. OCTOBER 3, 1975

James A. Michienzi

On October 3, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This case is before the court on plaintiff's 'motion for rehearing and reconsideration to alter or amend a judgment' and defendant's opposition thereto. Under the heading 'Conclusion' plaintiff makes statements which we treat as a request for rehearing *en banc* rather than by the present panel.

"The request for rehearing *en banc* has been considered by all the active judges of the court, and a majority not having voted in favor of such rehearing, the motion in that aspect is denied.

"The previous decision, *ante* at 484, may be summarized as resting on two propositions, that plaintiff failed to show that his expectations of promotion ever left the discretionary zone and became a legally protected right, or that the timing of the official actions he complained about were such that they had the pecuniary consequences on which our jurisdiction must rely, in view of plaintiff's voluntary retirement while his case was still pending in the Department of Defense. The Board for Correction of Military Records was not shown to be arbitrary or capricious in failing to see in plaintiff's case either 'error' or 'injustice'.

"Plaintiff's motion supplies an item of new information, *i.e.*, that his promotion recommendation of September 4 or October 23, 1970, did not lapse, but remained in effect until he was removed from that recommended promotion list by a Standby Advisory Board at some still unstated date after September 6, 1972. Defendant does not deny these statements so we assume they are true for purposes of this decision, though we point out that even supplemented as above, the record is woefully deficient in the kind of documentation and chronology of the official actions complained of which we would need before we could uphold a claim of this kind. We will correct our previous opinion, but it does not in any way undermine the reasons for our decision. It neither establishes that plaintiff had a legally protected right to promotion at any relevant time, nor that any official actions complained of, if wrongful, had the pecuniary impact on which our jurisdiction depends.

"Accordingly, upon consideration of the motion and defendant's opposition thereto, the said motion is denied. The previous decision of July 11, 1975, is amended as follows [these amendments have been incorporated in the report of the decision, *ante*]:

> Slip op., p. 6, line 8.—Delete sentence commencing 'At some point' to end of paragraph, and substitute:

> The September 4, 1970, selection published October 23, 1970, we believe was only advisory. *Weiss* v. *United States*, 187 Ct. Cl. 1, 408 F. 2d 416 (1969).

> Slip op., p. 6, last line on page. Delete sentence beginning 'The alleged outrages' and the following sentence on p. 7, which ends with the words: 'DASEB considered the case.'

> No substitution."

No. 11-75. OCTOBER 3, 1975

Berenice Warner

*Federal Employees' Group Life Insurance; waiver of insurance coverage; revocation of waiver.*—On October 3, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"This case comes before the court on defendant's motion for summary judgment, filed May 19, 1975. Plaintiff sues for proceeds under the Federal Employees' Group Life Insurance policy under which she claims her deceased husband was denied coverage. During 1968, decedent executed a waiver of both regular and optional life insurance. On August 29, 1972, decedent applied for disability retirement, which was approved on October 17, 1972. He also requested reinstatement of regular life insurance. No action was taken on this request. He died on November 4, 1972.

"Defendant was under no duty to revoke decedent's waiver. The statute does not provide for revocation of waiver. 5 U.S.C. § 8702(b) (1970). The privilege of revoking waiver is by Civil Service Commission regulation and decedent would not have fallen within the requirements. 5 C.F.R. §§ 870.204 and 871.205 (1975).

"Upon consideration of defendant's motion for summary judgment, plaintiff's response thereto and defendant's reply,

"IT IS ORDERED that defendant's motion for summary judgment be and is hereby granted and that plaintiff's petition is hereby dismissed.

"IT IS FURTHER ORDERED that plaintiff's 'Motion for Leave to File a Motion to Join Metropolitan Life Insurance Company as a Party Defendant' be and is hereby denied."

No. 88-75. OCTOBER 3, 1975

Cooper-MacDonald, Inc.

*Renegotiation of contracts; bond to stay execution of order of Renegotiation Board.*—On October 3, 1975 the court issued the following order (as amended by Order dated January 30, 1976):

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges.*

"This renegotiation case comes before the court on plaintiff's motion to fix and approve an amount of bond to stay execution of the Renegotiation Board's final order and defendant's motion for judgment in aid of execution of that final order. Despite our court's Rule 26(b), plaintiff failed to file a bond totaling 100 percent of the net excess profits found to be due by the Renegotiation Board within the requisite period of time. We have recently held in *Manufacturers Service Co.* v. *United States*, *ante* at 185, 518 F. 2d 1202, and *Bannercraft Clothing Co.* v. *United States*, *ante* at 199, 518 F. 2d 605, that such a 100 percent bond is necessary before we will stay execution of the Renegotiation Board's order. Plaintiff, in merely alleging financial difficulties, has failed to show that the granting of a judgment in aid of execution might serve to chill the *de novo* redetermination proceeding to which it is entitled. *See Sandnes' Sons, Inc.* v. *United States*, 199 Ct. Cl. 107, 117, 462 F. 2d 1388, 1394 (1972).

"IT IS THEREFORE ORDERED that without oral argument and upon the authority of *Bannercraft Clothing Co.* v. *United States*, *supra*, and *Manufacturers Service Co.* v. *United States*, *supra*, the plaintiff's motion to fix and approve amount of bond to stay execution of the Renegotiation Board's order is hereby denied and defendant's motion for judgment with interest at the statutory rate from January 30, 1975 until paid, in aid of execution at the Renegotiation Board's order is granted."

The parties have stipulated and agreed that as a result of a recent computation by the Internal Revenue Service of the credit due plaintiff for federal income taxes provided by Section 1481(b) of the Internal Revenue Code, correcting the net amount due by plaintiff for the three years involved in this case, the correct amount due by plaintiff is $916,465, plus interest at the statutory rate from January 30, 1975, until paid.

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No. 92–75. OCTOBER 3, 1975

William R. Pasquino

*Court of Claims jurisdiction; Federal Employees' Compensation Act; tort claim.*—On October 3, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges.*

"This case arises as a result of plaintiff's suit to "enforce benefit under the Federal Employee's Liability Act." Rather than filing an answer, the Government moves for a dismissal of plaintiff's petition on the grounds that it fails to state a claim upon which relief can be granted, alleging that this court has no jurisdiction over the subject matter in question here.

"Plaintiff, an employee of the United States Postal Service, allegedly injured his wrist while on duty with the Post Office. At the time of the injury plaintiff filed a notice of injury with the Office of Federal Employees Compensation and received on July 6, 1974, compensation for the costs of his medical attention. Subsequently, plaintiff has addressed several letters to that office seeking disability payments for what he claimed to be permanent and temporary injuries resulting from this incident, however, at no time did plaintiff file a formal claim for compensation. Having received no action, plaintiff now sues here for benefits he alleges is due him as a result of his injury.

"In his petition, plaintiff claims under the "Federal Employee's Liability Act," however, no act exists with this title. If plaintiff means the Federal Employers' Liability Act, 45 U.S.C. § 51 (1970), then his action is misplaced since that act applies only to employees of railroads and his petition would have to be dismissed. Presumably, therefore, plaintiff must be suing under the Federal Employees' Compensation Act (FECA), 5 U.S.C. § 8101 *et seq.* (1970) which compensates federal employees for death or disabilities incurred while employed at federal jobs. Section 8116(c) of this Act states that FECA is the exclusive remedy for a federal employee. Plaintiff would therefore be required to make his claim under the Act rather than through a suit in this court. The fact that plaintiff has never placed a formal claim under FECA for the injuries now complained of here is critical in view of the exclusivity of the Act in denying us jurisdiction over this action. Moreover, 5 U.S.C. § 8128 states that all decisions by the Secretary of Labor under this Act are final and 'not subject to review by another official of the United States or by a court by mandamus or otherwise. * * *' It is therefore clear to this court that we are without any jurisdiction to decide this case. Plaintiff's sole remedy appears to be under FECA and not here.

"Even if plaintiff claims that this was not such a work related injury as to be covered by FECA, his suit would have to be dismissed since it would then sound in tort, and this court has no jurisdiction over actions sounding in tort. *Eastport Steamship Corp.* v. *United States*, 178 Ct. Cl. 599, 372 F.2d 1002 (1967).

"IT IS THEREFORE ORDERED that without oral argument and for the reasons stated above, defendant's motion to dismiss this action is granted and plaintiff's petition is dismissed."

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**No. 263-72. OCTOBER 17, 1975**

**Gregson Bautzer, as the Executor of the Estate of Marion Douras Brown, a/k/a Marion Davies**

*Taxes; income tax; deductions; expenses; production of income; "ordinary and necessary" expenses* v. *capital contributions.*—Plaintiff seeks tax refund, claiming that legal and managerial services performed at the behest of decedent (Marion Davies) were rendered her personally and were deductible by her under Sec. 212 of the 1954 Internal Revenue Code as her ordinary and necessary expenses for the production of income or the management of property. On February 14, 1975 Trial Judge David Schwartz filed a recommended opinion (reported at 36 AFTR 75-5868, para. 75-5254, and 75-1 CCH USTC para. 9246), concluding that the payments made by Miss Davies or the estate of Miss

Davies under certain agreements to the attorneys were for services rendered to taxpayers other than Miss Davies, namely corporate entities in which Miss Davies was the sole stockholder, that on the record made the expenses for the services were not the ordinary expenses of decedent within the meaning of Sec. 212 and implementing Treasury Regulations, and that accordingly the estate of Miss Davies is not entitled to a deduction of these expenditures. This case came before the court on defendant's motion that the court adopt the recommended decision as the basis for its judgment, plaintiff having withdrawn a previously filed notice of intention to except. Upon consideration thereof, without oral argument, by order dated October 17, 1975 the court granted defendant's motion, adopted the decision as the basis for its judgment in this case, concluded that plaintiff is not entitled to recover, and dismissed the petition.

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No. 28-75. OCTOBER 17, 1975

Paul J. Savio

*Military pay; correction of military records; retroactive promotion; right to enlistment; demand for reinstatement and money damages.*—On October 17, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges.*

"In this military pay case, plaintiff, a terminated AUS Major, comes before the court with a petition seeking three alternative remedies: (1) reinstatement and retroactive promotion with appropriate back pay; (2) records correction and nullification of promotion passovers and (3) declaration of a right to enlist in the Army. Defendant moves to dismiss each count because it asserts that plaintiff has failed to state a claim for relief. Alternatively, defendant requests that we order plaintiff to amend his records correction count to include a claim for reinstatement and money damages should we decline to dismiss this count.

"Upon consideration of the briefs and without oral argument, we grant defendant's motion to dismiss the retroactive promotion and right to enlistment counts. We deny defendant's motion to dismiss the records correction count at this time. We grant plaintiff an additional thirty (30) days to amend his petition to include a demand for reinstatement and money damages in connection with the records correction count. If plaintiff fails so to amend, the defendant's motion to dismiss this count will be granted.

"Absent unique circumstances, this court declines to intervene in the promotion process. *Clinton* v. *United States*, 191 Ct. Cl. 604, 423 F. 2d 1367 (1970). Plaintiff's pleadings demonstrate that his promotion claim is not based upon a "clear legal entitlement." Thus we grant defendant's motion to dismiss the retroactive promotion count.

"In addition, the power to accept applications for enlistment is one within the discretion of the Secretaries of the Armed Services. 10 U.S.C. § 505 (1970). Just as there is no "vested right" to reenlist in the Armed Services absent a statute to the contrary, *Austin* v. *United States*, 206 Ct.Cl. 719 (1975), there is no "vested right" to enlist. Therefore we grant defendant's motion to dismiss plaintiff's "right to enlistment" claim.

"Clearly in order to obtain jurisdiction over an action, this court must be presented with a money damage claim. *Kirby* v. *United States*, 201 Ct. Cl. 527, 537 (1973), *cert. denied*, 417 U.S. 919 (1974). Plaintiff's second count seeking records correction and nullification of two promotion passovers fails to include such a claim. We could dismiss plaintiff's records correction count. However, the petition's deficiency may be due to a pleading oversight. Moreover, we note that count (1) did include a claim for back pay. Therefore, while we deny defendant's motion to dismiss count (2) at this time, we grant its alternative motion to require amendment of the petition to include a claim for reinstatement and money damages. If plaintiff fails so to amend his petition, we must dismiss for failure to state a claim within the court's jurisdiction. *Kirby* v. *United States*, *supra*.

"IT IS HEREBY ORDERED that without oral argument, defendant's motion for an order dismissing the retroactive promotion and right to enlistment counts for plaintiff's failure to state a claim for relief is hereby granted with prejudice.

"IT IS FURTHER ORDERED that defendant's motion for an order dismissing the records correction count for plaintiff's failure to state a claim for relief is hereby denied without prejudice. Plaintiff is granted thirty (30) days time in which to amend the records correction count to include a claim for money damage.* Upon the expiration of such time and the failure of plaintiff to offer such amendment, defendant's motion for an order dismissing the records correction count will be granted with prejudice without further action by the court."

No. 26-73. OCTOBER 24, 1975

Public Service Company of Oklahoma and Oklahoma Gas and Electric Company

*Contracts; Sec. 5 of the Flood Control Act of 1944; disposition of excess hydro-electric power and energy; rate increase; parol evidence.*—On October 24, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

"This case comes before the court on the parties' cross motions for summary judgment. Upon consideration of the motions and briefs of the parties, and after hearing oral argument, the court finds that there are material issues of fact which preclude disposition of this case by summary judgment.

"IT IS THEREFORE ORDERED that the cross motions for summary judgment are denied, and this case is hereby remanded to the trial judge with instructions as follows:

"(1) The trial judge shall assume without deciding that Section 5.2 of the contract entered into between the parties is ambiguous. Accordingly, he shall permit the introduction of parol evidence offered by the parties to show the meaning of Section 5.2 of the contract and, particularly, how they intended that this provision of the contract should be construed with reference to Section 5 of the Flood Control Act of 1944 (16 U.S.C. § 825s), and the trial judge shall make and report his findings of fact and conclusions of law on this issue.

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*On November 17, 1975 plaintiff filed a first amended petition.

"(2) The trial judge shall also hear evidence and make and report his findings of fact and conclusions of law on the issue as to whether the Secretary of the Interior, in setting the rates complained of by plaintiffs and confirmed and approved by the Federal Power Commission, acted arbitrarily, capriciously, or abused the discretion vested in him by Section 5 of the Flood Control Act of 1944 (16 U.S.C. § 825s)."

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NO. 222-73. OCTOBER 24, 1975

Economy Mechanical Industries, Inc., as the solvent joint venturer on behalf of a joint venture between Economy Mechanical Industries, Inc. and Lieb Bros., Inc.

*Pleading and practice; summary judgment; affidavits; issue of fact; voluntary dismissal of action.*—On October 24, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"This case comes before the court on motion of plaintiff, Economy Mechanical Industries, Inc., filed June 6, 1975, for summary judgment seeking to dismiss the third-party petition of David E. Feldman who has intervened on behalf of the Creditor's Committee of Lieb Bros., Inc., and plaintiff's action against the United States. Upon consideration thereof, without oral argument, it appears that the defendant, United States, has satisfied all of plaintiff's claims and therefore supports plaintiff's said motion. On the basis of Rule 101(f) and the decisions by this court in *Pacific Far East Line, Inc.* v. *United States*, 206 Ct. Cl. 378, 513 F. 2d 1355 (1975) and *Economy Plumbing and Heating Co.* v. *United States*, 197 Ct. Cl. 839, 456 F. 2d 713 (1972) it is concluded that plaintiff's motion for summary judgment should be granted as to the third-party petition and on the basis of *Routed Thru-Pac, Inc.* v. *United States*, 185 Ct. Cl. 428, 401 F. 2d 789 (1968) plaintiff's said motion should be granted for the dismissal of Plaintiff's claim against the defendant.

"IT IS THEREFORE ORDERED that plaintiff's said motion for summary judgment is granted in that the third-party petition of David E. Feldman, who has intervened on behalf of Creditor's Committee of Lieb Bros., Inc., is dismissed with prejudice and, further, in that the petition of the plaintiff against the defendant, United States, is dismissed with prejudice."

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NO. 351-74. OCTOBER 24, 1975

Al Aragon

*Contracts; implied contract; summary judgment; affidavit; issue of fact; stolen bonds; recovery fee.*—Plaintiff alleges that he entered into an oral contract with the Treasury Department for undercover services in the recovery of certain stolen bonds, that he was to receive 10% of the face value of whatever bonds were recovered; and that defendant breached the contract by refusing to pay him the amount due. Defendant denies that there was any contract, express or implied. On October 24, 1975 the court issued the following order:

Before SKELTON, *Judge*, Presiding, KASHIWA and KUNZIG, *Judges*.

"This case comes before the court on defendant's motion, filed May 7, 1975, for summary judgment to which plaintiff has filed no response and the time for so responding pursuant to the Rules of the court has expired. Upon consideration thereof, without oral argument, it is concluded on the basis of Rule 101(f) of the Rules of this court and the decisions in *Pacific Far East Line, Inc.* v. *United States*, 206 Ct. Cl. 378, 513 F. 2d 1355 (1975); *Operational Manuals, Inc.* v. *United States*, 205 Ct. Cl. 854 (1974); *Beach* v. *United States*, 226 U.S. 243 (1912); and, *Porter* v. *United States*, 204 Ct. Cl. 355, 366, 496 F. 2d 583 (1974), that plaintiff is not entitled to recover.

"IT IS THEREFORE ORDERED that defendant's said motion for summary judgment be and the same is granted and plaintiff's petition is dismissed."

No. 275–72. OCTOBER 30, 1975

Standard Dredging Corporation and Great Lakes Dredge and Dock Company, a Joint Venture

*Contracts; changed conditions; subsurface conditions; dike ruptures.*—On September 12, 1974 Trial Judge C. Murray Bernhardt filed a recommended decision (reported at 20 CCF para. 83,354), concluding that plaintiff was not entitled to additional compensation for costs incurred as a result of ruptures of dikes holding dredged material. This case came before the court on plaintiff's request for review by the court of the said recommended decision on plaintiff's and defendant's motions for summary judgment, having been submitted to the court without oral argument. Since the court (DAVIS, *Judge* Presiding, SKELTON and KUNZIG, *Judges*) agrees with the recommended decision, on October 30, 1975 it affirmed and adopted the same as the basis for its judgment in this case, denied plaintiff's motion for summary judgment, granted defendant's cross-motion, and dismissed the petition.

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No. 318–73. OCTOBER 30, 1975

Burtco Company, Inc.

*Contracts; interpretation.*—In a recommended decision filed July 31, 1975 (reported at 21 CCF para. 84,126), Trial Judge Louis Spector concluded that the contractor was entitled to additional compensation for providing support service for five radar vans because the contract documents required only that it perform the work on one van. This case came before the court on a stipulation for entry of judgment signed on behalf of both parties by their respective attorneys of record, whereby plaintiff agreed to accept the sum of $10,534.48 in full settlement of all claims set forth in the petition, and defendant consented to the entry of judgment in that amount. On October 30, 1975 the court, by order, entered judgment for plaintiff for $10,534.48.

APP. NO. 18–74. OCTOBER 30, 1975

### United States v. The Fort Peck Indians of the Fort Peck Reservation, Montana

*Indian claims; appeal from Indian Claims Commission; interest on Indian funds deposited in United States Treasury; remand to Commission.*—On October 30, 1975 the court issued the following order:

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges.*

"This case comes before the court on appeal by the United States from determinations of the Indian Claims Commission in its Docket No. 184, having been submitted to this court on the briefs and oral argument of counsel. Upon consideration thereof, the court concludes as follows:

"1. On the issue of the correctness of the Indian Claims Commision's award of interest on various Indian tribal funds, which award was rested squarely on the Act of September 11, 1841 [5 Stat. 465], the judgment of the Commission is reversed on the authority of *United States* v. *Mescalero Apache Tribe*, Appeal Nos. 2–74, 10–74, 12–74, decided July 11, 1975, *ante*, at 369, 518 F. 2d 1309, and the case is remanded to the Commission for such further proceedings regarding the productivity of the tribal funds as may be appropriate and open to the parties. *Cf. Cheyenne-Arapaho Tribes of Indians* v. *United States*, 206 Ct. Cl. 340, 512 F. 2d 1390 (1975). The court intimates no opinion whatever as to whether (and the extent to which) such further proceedings are now available.

"2. On the issue of the Commission's jurisdiction in this case to order an accounting for governmental activities occurring after August 13, 1946, the court deems, in view of its disposition of the first issue, that the appeal is now premature under the Indian Claims Commission Act—the Commission's determination on this point being neither a "final determination" nor an interlocutory determination establishing the liability of the United States under § 20(b) of the Act, 25 U.S.C. § 70s(b). *See United States* v. *Fort Sill Apache Tribe*, 202 Ct. Cl. 525, 481 F. 2d 1294 (1973). Accordingly, this aspect of the appeal is dismissed without prejudice.

"3. The appellant's points with respect to the assertion by appellee, after August 13, 1951, of a claim of a Fifth Amendment taking for the school lands, and with respect to the paying out of tribal funds under the Act of May 30, 1908 [35 Stat. 558], are likewise premature and not appealable at the present stage to this court. It is undisputed that no final determination has been made, and on neither issue did the Commission's action (of which review is sought) constitute an interlocutory determination establishing the liability of the United States. *See* the *Fort Sill* opinion, supra. These two aspects of the appeal are therefore dismissed without prejudice.

"IT IS THEREFORE ORDERED that the aspects of the appeal as set forth in paragraphs 2 and 3 above are dismissed without prejudice and that on the issue set forth in paragraph 1 above the case is remanded to the Indian Claims Commission for further proceedings."

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NOS. 171–74 AND 174–74. OCTOBER 30, 1975

Crest Construction Corporation

*Contracts; interpretation; pre-contract knowledge; collateral estoppel re decisions of Contract Appeals Board.*—On October 30, 1975 the court issued the following order:

Before DAVIS, *Judge*, Presiding, NICHOLS and KUNZIG, *Judges*.

"These cases come before the court on plaintiff's motion, filed December 18, 1974, and defendant's cross-motion, filed April 2, 1975, for summary judgment, having been submitted on the briefs and oral argument of counsel.

"In No. 174–74 the Board of Contract Appeals cannot be faulted for refusing to interpret the contract as forbidding the Government from designating for disposal (of excess excavated material) a spoil area on Government land two miles distant from the excavation and from the area characterized on the Site Plan as "limits of the contract." The text of the particular clause on excess material did not so prescribe. Particularly in the light of the Board's well supported finding as to plaintiff's pre-contract knowledge of the type of soil to be excavated, it was not reasonable to draw from the contract, as a whole, the requirement that all the excess material had to be deposited within the "limits of the contract"—a small and crowded area immediately adjacent to the Academic Building of the U.S. Army Logistic Management Center. At the very best for plaintiff the contract documents created a patent ambiguity calling for inquiry by the plaintiff before undertaking the work. *Space Corp.* v. *United States*, 200 Ct. Cl. 1, 5, 470 F. 2d 536, 539 (1972).

"In No. 171–74 the Board was correct in holding that the claim was barred by collateral estoppel. Though the first demand was under the Changes article, the Board properly found, in the course of deciding that case, that the contractor had met no condition that was unexpected, or other than as represented. This factual finding wholly precluded the claim later separately filed under the Changed Conditions clause.

"IT IS THEREFORE CONCLUDED AND ORDERED that plaintiff is not entitled to recover and plaintiff's motion for summary judgment is denied, defendant's cross-motion for summary judgment is granted and plaintiff's petitions are dismissed."

On January 30, 1976 plaintiff's motion for rehearing and further relief was denied, and defendant's motion to strike all evidence not considered by the Armed Services Board of Contract Appeals was denied as unnecessary in view of denial of plaintiff's said motion.

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No. 276–74. OCTOBER 30, 1975

Central States Health & Life Company of Omaha

*Taxes; income tax; life insurance companies; deductions for guaranteed renewable health and accident insurance contracts.*—Plaintiff alleges it overpaid its income taxes for years 1965, 1966 and 1969, and seeks refund, together with assessed interest and statutory interest. On October 30, 1975 the court issued the following order:

Before DAVIS, *Judge*, Presiding, SKELTON and KUNZIG, *Judges*.

"This case comes before the court on plaintiff's motion, filed January 10, 1975, and defendant's cross-motion, filed April 18, 1975, for partial summary judgment having been submitted on statements of counsel and the briefs of the parties. Upon consideration thereof, based upon the decisions of this court in *United American Ins. Co.* v. *United States*, 201 Ct. Cl. 32, 475 F. 2d 612 (1973), and *Lincoln Nat'l Life Ins. Co.* v. *United States*, Ct. Cl. No. 521-69, decided [as to Part IX of the petition] by order of January 4, 1974 [unreported].

"IT IS ORDERED that defendant's said motion for partial summary judgment is denied, that plaintiff's said motion for partial summary judgment is granted and judgment is entered for plaintiff accordingly on the issues stated in paragraphs 10 through 14 and 24 through 26 of the petition and answer, with the amount of plaintiff's recovery to be determined pursuant to Rule 131(c) after determination of the remaining issues between the parties in this case."

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NO. 297-74. OCTOBER 30, 1975

John R. Pastore

*Civilian pay; reduction in force; separation; failure to exhaust administrative remedies.*—On October 30, 1975 the court issued the following order:

Before NICHOLS, *Judge*, Presiding, DURFEE, *Senior Judge*, and KASHIWA, *Judge*.

"This civilian pay case arises out of plaintiff's separation from Federal service by a reduction-in-force order. Plaintiff, a preference eligible veteran, was employed as a civilian Research Physical Scientist (GS-1301.1.1-13-7) at the Night Vision Laboratory, an element of the United States Army Electronics Command, located at Fort Belvoir, Virginia. Plaintiff was notified by letter in April 1972 of the abolishment of his position pursuant to a reduction-in-force (RIF). In lieu of separation, plaintiff was offered the position of Physical Science Technician (GS-1311-12) at his then existing salary with two years' salary retention. Plaintiff originally accepted the offered position, but on reconsideration, declined the offered position, and accepted separation by RIF. Plaintiff was duly separated by RIF on July 31, 1972.

"Plaintiff appealed his separation to the Civil Service Commission's Appeals Examining Office. That office, after personal appearance by plaintiff, sustained plaintiff's RIF separation. On timely appeal to the Civil Service Commission's Board of Appeals and Review (BAR), that Board affirmed plaintiff's RIF separation.

"Plaintiff thereupon filed suit in this court seeking a declaratory judgment, injunctive relief, reinstatement, back pay, attorneys' fees and costs. The case comes before the court on defendant's motion for summary judgment, and plaintiff's cross-motion for summary judgment. Upon consideration of the parties' briefs submitted with their respective motions, supporting documents and after oral argument by counsel, the court finds:

"(1) The Civil Service Commission correctly concluded in a detailed, thorough and supported decision that plaintiff's separation was accomplished through a valid RIF procedure in accord with all applicable personnel regulations and violated none of plaintiff's separation rights.

"Contrary to plaintiff's contention, for which he provides no authority, RIF separations are not adverse actions reviewable under the standards of 5 U.S.C. § 7512(a). *Wilmot* v. *United States*, 205 Ct. Cl. 666 (1974).

"The Civil Service Commission's detailed review of the highly technical specialties of the employees at the Army's Night Vision Laboratory, which plaintiff fails to attack, and counsel's admission as to the uniqueness of plaintiff's position as a laser crystal grower, more than adequately refutes plaintiff's contention that his RIF separation was predicated on an improperly constructed retention register.

"(2) In addition to seeking relief which is not within our jurisdiction in this case, *i.e.*, reinstatement, injunctive relief, attorneys' fees and costs, plaintiff throughout the argument has not addressed himself to the basic question involved in this appeal: whether the decision of the Civil Service Commission's Board of Appeals and Review is arbitrary, capricious, or unsupported by substantial evidence, without specific identification of error in the BAR's decision, the court is unable to conclude that the same was arbitrary, capricious or unsupported by substantial evidence.

"(3) Plaintiff failed to argue before the Civil Service Commission's Board of Appeals and Review that his function was transferred pursuant to 5 U.S.C. § 3503(a), and that his RIF separation was in violation of Fort Belvoir Regulation No. 690–38. Plaintiff is now precluded from presenting this issue on appeal. *Haynes* v. *United States*, 190 Ct. Cl. 9, 418 F.2d 1380 (1969). In any event, we find no merit in these arguments.

"(4) In its decision, the Civil Service Commission's Board of Appeals and Review made extensive analysis and findings as to most of plaintiff's contentions which are not arbitrary, capricious, and which are supported by substantial evidence.

"IT IS THEREFORE ORDERED that defendant's motion for summary judgment be granted, plaintiff's cross-motion for summary judgment be denied, and plaintiff's petition dismissed."

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No. 363–74. OCTOBER 30, 1975

Valentine Untalan

*Military pay; computation of retired pay; recomputation of retired pay to reflect later active duty.*—On October 30, 1975 the court issued the following order:

Before COWEN, *Chief Judge*, LARAMORE, *Senior Judge*, and BENNETT, *Judge*.

"This case before the court presents the question of whether plaintiff, a Regular Army enlisted man, retired for length of service and, at his request, later recalled to active duty as an enlisted man, and thereafter in 1971 released because he was found physically unfit for duty, to a degree of 30 percent, is entitled to advancement to the grade of Major, the highest grade he held as a Reserve officer. Plaintiff performed no active duty as a Major but had such duty as a Lieutenant.

"Plaintiff says that in denying him such advancement the Department of the Army acted arbitrarily, capriciously, and contrary to law, and that he should have been re-retired at the higher commissioned grade instead of reverting to the highest enlisted grade he achieved on active duty. We think plaintiff's claim to be without legal merit.

"Plaintiff reverted to his retired status with full credit for his additional active service, a higher grade earned therein, and his disability, pursuant to an explicit order citing 10 U.S.C. § 1402(b) (1970) as authority for the action. That section fits plaintiff's factual situation. It says, in part:

> § 1402. Recomputation of retired or retainer pay to reflect later active duty.
>
> * * * * *
>
> (b) A member of an armed force who has been retired other than for physical disability, and who while on active duty incurs a physical disability of at least 30 percent * * * is entitled, upon his release from active duty, to retired pay under subsection (d).

"Subsection (d) prescribes the method of recomputation of benefits used for plaintiff here. The subsection is implemented by Army Regulation 635-40, paras. 1-15, 15 May 1967, also applied here. It is conceded that plaintiff, under appropriate sections of the statutes, could have retired as a 1st Lieutenant but that he waived his right to do so because it was less financially advantageous to him.

"Plaintiff now complains that he should have been re-retired under 10 U.S.C. § 1372 (1970) which states, in pertinent part:

> § 1372. Grade on retirement for physical disability: members of armed forces.
>
> Unless entitled to a higher retired grade under some other provision of law, any member of an armed force who is retired for physical disability under section 1201 or 1204 of this title, * * *, is entitled to the grade equivalent to * * *
>
> (2) The highest temporary grade or rank in which he served satisfactorily, as determined by the Secretary of the armed force from which he is retired.

"Plaintiff also cites the court to other sections of the statutes including 10 U.S.C. §§ 1203, 1375, 3964, and 1401.

"Where plaintiff fails here is that, as shown above, he simply was not retired under 10 U.S.C. §§ 1201 or 1204 nor have we been shown why these general sections are applicable and the specific section, § 1402, 'Recomputation of retired or retainer pay to reflect later active duty,' which fits plaintiff's factual situation, is inapplicable. Plaintiff did not in his brief respond to this threshold issue raised by defendant's motion. In oral argument plaintiff' s counsel conceded that the latter section was indeed applicable but urged that the other sections could also be applicable. We have examined all pertinent sections and all cases relied upon by plaintiff and find them inapposite as to section 1402. Defendant relies on an opinion by the Judge Advocate General in a strikingly parallel case, JAGA 1971/4921, 2 September 1971.

"Plaintiff has appealed unsuccessfully to the Army Board for Correction of Military Records. Plaintiff has not briefed and has abandoned his claim to a 40-percent disability rating as a part of the pending claim.

"Upon consideration of the motions, the briefs, authorities relied upon by both parties, and upon oral argument,

"IT IS THEREFORE ORDERED that plaintiff's motion for summary judgment be denied. Defendant's cross-motion for summary judgment is granted. The petition is dismissed."

On January 9, 1976 the court denied plaintiff's motion for reconsideration.

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NO. 403-74. OCTOBER 30, 1975

Jack Picoult Construction

*Contracts; interpretation; Changes Article; allowable overhead, profit and commission percentages; subcontractor's supervision of second-tier subcontractor; overhead* v. *direct cost.*—On October 30, 1975 the court issued the following order:

Before DAVIS, *Presiding Judge*, SKELTON and KUNZIG, *Judges.*

"In this Wunderlich Act review case, plaintiff Jack Picoult was prime contractor on a United States Government contract for the improvement and repair of a Post Office in Newark, New Jersey, at a cost in excess of $2.5 million. During the course of the work, the contracting officer issued a change order which affected the air conditioning and sheet metal portion of the job. Plaintiff's mechanical subcontractor, Hudik-Ross, Inc., handled the air conditioning work, and referred the sheet metal work to a second-tier subcontractor, Hershman Sheet Metal Works, Inc. Hudik-Ross had to provide three of its own personnel to supervise the sheet metal work performed by Hershman. Under the terms of the Government contract, subcontractors were entitled to ten percent allowances for overhead and ten percent for profit, with the prime contractor getting another ten percent as commission on work done by personnel other than his own. This arrangement is known as the '3 10's.' Hershman and Picoult were paid accordingly, but Hudik-Ross received no reimbursement for the work of its supervisory personnel. Through the plaintiff, Hudik-Ross petitioned the contracting officer for reimbursement, and failing there, appealed to the General Services Administration Board of Contract Appeals. Having been denied by the Board, plaintiff now sues in this court seeking the reimbursement for Hudik-Ross. The case is before us on cross-motions for summary judgment.

"The issue here is one of contract interpretation. The contract specifically provided, in Section 1-23 ('Changes') that 'allowable overhead, profit and commission percentages [i.e., a maximum of 10% on each] * * * shall include * * * field and office supervisors and assistants.' The personnel provided by Hudik-Ross were of that type. Hence, the costs involved in paying them are 'overhead,' and not direct costs, which would be reimbursable under the 'Changes' article. There is no ambiguity in the contract; the cited portions clearly cover the dispute here. The contract did not provide for any supervisory compensation beyond the '3 10's' which have already been paid.

"For the foregoing reasons, it is ordered that the defendant's cross-motion for summary judgment is granted. Plaintiff's motion for summary judgment is denied, and the petition is dismissed."

# JUDGMENT ORDERS

## MAY 1, 1975 TO OCTOBER 31, 1975

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### SAMUEL L. PALMER AND STANDARD PARTS AND EQUIPMENT CORPORATION V. THE UNITED STATES

No. 86-66

[182 Ct. Cl. 896; 191 Ct. Cl. 346, 423 F. 2d 316]

Pursuant to a stipulation for settlement whereby plaintiffs agreed to accept $125,000 to settle this action by fully releasing defendant from all claims for the manufacture or use by or for the United States of all inventions covered by the patent in suit up to the date of final judgment and by granting to defendant a fully paid-up license under the patent from said final judgment date up to the date of expiration, the court on June 8, 1973 entered judgment for plaintiffs in the sum of $125,000. (This is a belated report of the judgment order.)

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### NATIONAL ADVERTISING COMPANY V. THE UNITED STATES

No. 47-71

[205 Ct. Cl. 728, 507 F. 2d 850]

On May 9, 1975 the court ordered that judgment be entered for plaintiff as follows:

| *Year* | *Tax* | *Assessed Interest* |
|---|---|---|
| 1962 | $28, 079. 50 | $1, 101. 62 |
| 1963 | 86, 502. 00 | 27, 680. 00 |
| 1964 | 132, 797. 00 | 34, 527. 00 |
| 1965 | 156, 775. 00 | 31, 354. 00 |

The court further ordered that plaintiff be allowed interest as provided by law on the above amounts, such interest to commence on July 15, 1969 on all tax and assessed interest balances for 1963, 1964 and 1965 and on December 20, 1965 as to $6,676.50 of tax and all assessed interest for 1962 and on January 1, 1966 on the remaining balance of 1962 tax.

### UNION PACIFIC RAILROAD COMPANY V. THE UNITED STATES

No. 198-73

On May 30, 1975 the court ordered that judgment be entered for plaintiff in the sum of $2,343.59 and dismissed defendant's counterclaim with prejudice.

### SACRAMENTO NORTHERN RAILWAY V. THE UNITED STATES

No. 441-74

On May 30, 1975 the court ordered that judgment be entered for plaintiff in the sum of $542.56.

### WESTERN PACIFIC RAILROAD COMPANY V. THE UNITED STATES

No. 440-74

On June 13, 1975 the court ordered that judgment be entered for plaintiff in the sum of $563.89.

### PHOTOCIRCUITS CORPORATION V. THE UNITED STATES

No. 28-69

[204 Ct. Cl. 821, 824]

On June 27, 1975 the court ordered that judgment be entered for plaintiff in the sum of $37,775.78, plus statutory interest as provided by law, as follows: on $4,531.80 from September 26, 1962; on an additional $5,311.57 from October 15, 1962; and on an additional $26,830.16 from June 18, 1968.

### WILLIAM D. STODDART, III v. THE UNITED STATES

No. 193-68
[205 Ct. Cl. 847]

On July 25, 1975 the court ordered that judgment be entered for plaintiff in the sum of $68,241.89.

### KOPPERS/CLOUGH, A JOINT VENTURE v. THE UNITED STATES

No. 516-71
[201 Ct. Cl. 344]

Following the opinion of the court dated April 13, 1973, reported at 201 Ct. Cl. 344, and remand to the trial judge, on August 1, 1975, the court issued an order entering judgment for plaintiff for $2,687,000 consonant with a stipulation of settlement between the parties. The court also dismissed with prejudice defendant's offset or counterclaim.

### ODGEN PHIPPS AND LILLIAN B. PHIPPS v. THE UNITED STATES

No. 109-72
[206 Ct. Cl. 583, 515 F. 2d 1099]

On August 1, 1975 the court ordered that judgment be entered for plaintiffs in the sum of $22,341.26, plus statutory interest thereon.

### GREAT AMERICAN INSURANCE COMPANY v. THE UNITED STATES; AND T. G. WILLIAMSON, D/B/A WILLIAMSON CONSTRUCTION COMPANY AND BOULEVARD STATE BANK

No. 151-72
[203 Ct. Cl. 592, 492 F. 2d 821; 203 Ct. Cl. 754]

Following the opinion of the court dated February 20, 1974 (as amended) (203 Ct. Cl. 592, 492 F. 2d 821; 203 Ct. Cl. 754), the court issued an order on August 1, 1975 entering judgment for plaintiff and against the United States for $11,410; entering judgment for defendant and against third-party defendant, T. C. Williamson, d/b/a Williamson Construction Co., for $7,108, the judgment being deemed satisfied in full by applying said sum to retainages; and dismissing the petition respecting third-party defendant, Boulevard State Bank.

### LYKES BROS. STEAMSHIP COMPANY, INC., V. THE UNITED STATES

No. 375–69

[206 Ct. Cl. 354, 513 F. 2d 1342]

On August 29, 1975 the court ordered that judgment be entered for plaintiff in the sum of $673,432.88, together with interest thereon as provided by law.

### KFOX, INC. V. THE UNITED STATES

No. 151–71

[206 Ct. Cl. 143, 510 F. 2d 1365]

On September 19, 1975 the court ordered that judgment be entered for plaintiff as follows:

| *Taxable period* | *Tax* | *Assessed Interest* |
|---|---|---|
| Fiscal year ended 11/30/63 | $47,419.43 | $17,798.91 |
| Period 12/1/63–12/31/63 | 3,945.12 | 1,459.70 |
| Calendar year 1964 | 45,516.39 | 13,726.63 |
| Calendar year 1965 | 35,458.12 | 8,574.52 |
| Calendar year 1966 | 14,043.21 | 1,582.70 |

together with interest on the above amounts as provided by law.

### TRUSTEES OF THE GRACELAND CEMETERY IMPROVEMENT FUND, ET AL. V. THE UNITED STATES

Nos. 446–69, 447–69, 448–69 and 449–69

[206 Ct. Cl. 609, 515 F. 2d 763; 206 Ct. Cl. 901]

On September 25, 1975 the court ordered that judgment be entered for plaintiff in the sum of $570,382.60, together with interest thereon according to law from the date of payment.

### ESTATE OF SAMUEL E. BOGLEY, LEONARD S. MELROD AND WARREN BROWNING, CO-ADMINISTRATORS V. THE UNITED STATES

No. 52–73

[206 Ct. Cl. 695,514 F. 2d 1027]

On October 3, 1975 the court ordered that judgment be entered for plaintiff in the sum of $24,957.02, plus statutory interest as provided by law.

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### ELIZABETH KLINE JORDAN AND LEA ASSOCIATES, INC. V. THE UNITED STATES

No. 433–66

[195 Ct. Cl. 184, 444 F. 2d 557]

On October 30, 1975 the court ordered that judgment be entered for defendant in the sum of $40,690.02, plus interest according to law and the petition with respect to all remaining issues was dismissed with prejudice. Plaintiff's petition for certiorari was denied April 5, 1976.

# REPORT OF DECISIONS

## OF

## THE SUPREME COURT

## IN COURT OF CLAIMS CASES

Action was taken by the United States Supreme Court on the parties' petitions for writs of certiorari as follows:

| Petitioners | Ct. Cl. | F. 2d | Supreme Court |
|---|---|---|---|
| | | | Denied |
| Marion G. Denton<br>No. 319–72 | 204:188 | | 421 U.S. 963<br>May 12, 1975 |
| Rubin Borasky<br>No. 358–72 | 204:874 | | 421 U.S. 977<br>May 19, 1975 |
| James W. Brundage<br>No. 442–72 | 205:502 | 504:1382 | 421 U.S. 998<br>June 2, 1975 |
| Service Technicians, Inc<br>No. 199–73 | 206:833 | | 421 U.S. 1011<br>June 9, 1975 |
| Richard G. Augenblick<br>No. 357–64 | 187:727 | | 422 U.S. 1007<br>June 16, 1975 |
| Richard G. Augenblick<br>No. 357–64 | 206:74 | 509:1157 | 422 U.S. 1007<br>June 16, 1975 |
| Bethlehem Steel Corp<br>No. 44–68 | 206:122 | 511:529 | 423 U.S. 840<br>Oct. 6, 1975 |
| Aubrey E. Douglas<br>No. 197–70 | 206:96 | 510:364 | 423 U.S. 825<br>Oct. 6, 1975 |
| Michael Bruce Kaye<br>No. 76–72 | 206:829 | | 423 U.S. 859<br>Oct. 6, 1975 |
| Anne H. Hampton, Exec<br>No. 126–73 | 206:422 | 513:1234 | 423 U.S. 837<br>Oct. 6, 1975 |
| Contra Costa Co. Water Dist<br>No. 420–73 | 206:836 | | 423 U.S. 830<br>Oct. 6, 1975 |
| Richard E. Warner<br>No. 190–74 | 205:878 | | 423 U.S. 843<br>Oct. 6, 1975 |
| James O. Ming<br>No. 155–74 | 206:877 | | 423 U.S. 891<br>Oct. 14, 1975 |
| John Samuel Austin<br>No. 5–74 | 206:719 | | 423 U.S. 911<br>Oct. 20, 1975 |
| | | | Granted |
| Roy C. Hopkins<br>No. 342–72 | 206:303 | 513:1360 | 423 U.S. 821<br>Oct. 6, 1975 |

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ADMIRALTY CLAIM. Gulf Refining
AGENCY LEVEL HEARING. West
AIR FORCE REGULATIONS. Boyd; Bray; Sharp
ANTICIPATED OR LOST PROFITS. Brown; Northern Helex
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    Failure to exhaust
      Syl. 3, Christie
  ADVERSE PERSONNEL ACTION
    Resignation, voluntary
      Syl. 8, Christie
  APPOINTMENT AND TENURE
    Administrative or executive function
      Compensation, entitlement and amount
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